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Canadian Foreign Aid Policy, 1965-1974

by

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research, for acceptance, a thesis entitled Canadian Foreign Aid Policy, 1965-1974 submitted by William P. Donahue in partial fulfilment of the requirements for the degree of Master of Arts.

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INTRODUCTION

> The failure of world society to provide "a safe and happy life" for all is not caused by any present lack of physical resources. The problem today is not one of absolute physical shortage but of economic and social maldistribution and misuse; mankind's predicament is rooted primarily in economic and social structures and behavior within and between nations.
>
> Barbara Ward
> "The Declaration of Cocoyoc"[1]

A great deal of attention has been paid recently to an integrated approach to international development. The call for a "New International Economic Order" entails a re-evaluation of the economic relationships between rich and poor countries.[2] Developing nations are now demanding international measures which will stabilize their commodity prices, increase processing (value added) for their raw materials, create preferences for their

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[1]Quoted in <u>The New Internationalist</u>, No. 35 (October, 1975), p. 11.

[2]"A Declaration on the Establishment of a New International Economic Order" was achieved by consensus at the Sixth Special Session of the United Nations General Assembly in April, 1974.

manufacturing, reduce non-tariff barriers in developed markets, insure the transfer of appropriate technologies, and include them in international monetary reform.

In the 'fifties and 'sixties, foreign aid played a major role in the economic relationships between developed and developing nations. Many early disciples of foreign aid believed that foreign aid alone could eradicate world poverty and bring about global economic development. When this unrealistic expectation was not realized, reformists began to talk of selective development and "take-off into self-sustaining growth."[3] This reformist view was equally misleading and was "merely a rationalization of donors' hopes to be rid of aid before too long."[4] The presumed failure of aid to provide unrealistic results led to a general disillusionment on the part of donors and recipients alike.

> Among illusionists, there was a tendency to jump to the conclusion that aid, or at least the aid of their imaginings, had had its day, and to seek some alternatives, such as massive reorganization of world trade, on which a new illusion could be built.[5]

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[3]W. W. Rostow, ed., The Economics of Take-off into Sustained Growth (London: Macmillan and Co., Ltd., 1963).

[4]Paul Streeten, "A Poor Nation's Guide to Getting Aid," New Society (1 February 1968), p. 154.

[5]John White, The Politics of Foreign Aid (London: The Bodley Head, 1974), p. 15.

Foreign aid is only one aspect, albeit an important one, in the development process and must be considered in the context of limited objectives over the longer term. The United Nations Conference on Trade and Development recognized that there was no single solution to development when it dropped its call for "trade not aid" and replaced it with "trade as well as aid."[6]

Foreign aid can best be understood by regarding it as a contribution "at the margin" in a developing economy. It is not the purpose of aid to develop an economy but rather to hasten the day when development will be achieved. Aid, like development itself, is necessarily a long-term endeavour. If aid is to contribute at the margin of a developing economy, then it must be targeted at the needs of that economy.

In order to study the role of aid in the development process, it must be distinguishable from other components. Misplaced aggregation in a number of areas has blurred the role of aid in the development process and made analysis unnecessarily difficult. Governmemts have replaced the word "aid" with more aggregative phrases such as "development assistance" and "official flows of

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[6]Harold Caustin, "Aid," in Dudley Seers and Leonard Joy, eds., Development in a Divided World (Middlesex: Pelican, 1971), p. 317.

resources," which mix grants, loans, trade incentives and direct private investment under the same heading. Terms such as the "Third World" are another form of aggregation and are essentially misleading. Development research and policy has tended to regard all aid recipients equally and thus failed to distinguish significant economic, political and demographic differences among these nations. Only recently have we begun to look at such crude distinctions as the resource poor, the land-locked and the least developed (LLDC's) nations. Thus, in order to understand the role of aid in the development process we must begin to acknowledge the difference between various transfers and also begin to distinguish between recipients.

A growing number of people are opposed to giving foreign aid. The "left" argues that aid is imperialistic or a form of neo-colonialism while the "right" points to lack of objective results.[7] This study does not attempt to provide a rationale for giving aid or to defend the concept but addresses itself to those who believe that foreign aid is a necessary part of the development process. The first two Chapters provide a conceptual analysis of the

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[7]For "left" position see Teresa Hayter, Aid as Imperialism (Middlesex: Penguin, 1971); for "right" view see P. T. Bauer, "Dissent on Foreign Aid" in Gerald M. Meier, ed., Leading Issues in Economic Development: Studies in International Poverty, Second. ed. (Singapore: Oxford University Press, 1971).

concept of aid and its measurement. The final two Chapters present an analysis of the aid policies of the Canadian government.

CHAPTER 1

THE DEFINITION OF FOREIGN AID

In the past three decades the term "foreign aid" has become an established part of the Canadian vernacular. Indeed, many Canadians hold strong views, either pro or con, regarding Canada's foreign aid programme. When millions of eggs spoil there is public outcry because this food could have been given to the needy around the world. When unemployment rises in Canada, many decry foreign aid asserting that "charity begins at home."

For all its usage there probably exist few terms which are more poorly understood in Canada today than "foreign aid." In part, this study will attempt to clarify the confusion which has arisen as to the meaning of "foreign aid." A great many terms are used as synonyms for aid--development assistance (official and private), resources flows (gross and net), export credits, soft loans, grant-like flows and even trade preferences. In fact, Canadians are subjected to a flood of information regarding Canadian aid. CIDA sends wheat to Bangladesh,

builds a dam in Brazil, or makes a loan to Nigeria to increase chicken production in that country. What, out of all these types of activities, can be seen as foreign aid? Are loans foreign aid in the same manner as gifts? The United States is by far the largest aid donor in the international scene. If one looks at U.S. aid, much of what passes for aid is military assistance, export credits available to any country willing to buy American goods, and U.S. government guarantees to private American firms undertaking commercial enterprise in the Third World. Clearly, this type of aid differs from what the non-expert considers to be foreign aid. What is required then is a working definition upon which there can be some agreement as to what is, and is not, aid.

It is absolutely necessary, therefore, to have some notion of what is and is not aid <u>before</u> one looks at the total flow of resources to examine Canada's performance <u>vis à vis</u> other donors. Delimiting the investigation to official flow, however, is not enough.

> Different organizations and different countries include or exclude a variety of items. Thus, the Development Assistance Committee /DAC/ of the OEDC records "the flow of long-term financial resources to less developed countries and multilateral agencies" and this includes both official flows and private investment, private lending and export credits. Some bodies do not record private capital flows. But it is not merely a question of whether aid should include

> flows of private resources, for official flows are very heterogeneous in character; including outright grants, loans on different terms of interest and repayment, funds in convertible currencies and funds which are tied to spending in one country and which also may be tied to specific uses. Simple aggregation is therefore almost meaningless and certainly misleading.[1]

Harry Johnson is somewhat less kind when he refers to such reporting as a "rag bag of economically incomparable transactions."[2]

A definition of aid is therefore required so that such statistics can be distilled into meaningful form. For the purposes of this study, aid is: <u>the official unidirectional transfer of real resources from developed nations to developing nations, for the purpose of promoting the economic development of the recipient</u>. Hopefully, this definition delimits that portion of the total flow which can be considered aid while at the same time satisfying the criteria of both expert and non-expert usage.

The use of the word "unidirectional" is meant to point out the fact that there is a negative flow from developing nations to developed nations. Clearly, this is the distinction between a grant and a loan. By

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[1] J. M. Healey, <u>The Economics of Aid</u> (Middlesex: Penguin Books Ltd., 1971), p. 1.

[2] H. G. Johnson, <u>Economic Policies Towards Less Developed Nations</u> (Washington: Brookings Institute, 1967), p. 118.

definition, a loan promises future repayment. Not only money flows out of developing nations, but human capital as well. The so-called "brain-drain" in the Third World denotes this reverse flow. As Gerald Helleiner puts it, "large numbers of educated people . . . are 'voting with their feet' to join the developed world."[3] Loans, by definition, imply a reverse flow of resources from the client to the lender. In actuality, one should deduct the brain-drain from the technical assistance programmes of the developing nations in order to arrive at the unrequited transfer which we are calling aid.

An important aspect of the definition just presented is the specification of aid as the transfer of real resources. All too often, there is a tendency to confuse the accounting procedure of aid with the actual aid transfer. In other words, the dollar value of aid is an accounting mechanism used by a donor country to account for the amount of resources involved in the transfer. "It is doubtful whether any government suffers. . . from money illusion" concerning its aid commitments.[4] When Allan MacEachen, the present Secretary of State for External Affairs, announces that Canada's aid budget will be

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[3]Gerald Helleiner, "The Development Business: Next Steps," International Journal, XXV (Winter, 1969-70), p. 160.

[4]Johnson, Economic Policies, p. 121.

$933 million for the fiscal year 1975-76,[5] he is only using economic shorthand to say that Canada's aid programme will involve that amount of Canadian resources which can be accounted for by that amount of currency. He might as well have said that Canada will devote so many tractors, so many doctors or so many tons of wheat to its aid programme.

When experts from the developing nations themselves talk about financing local costs in developing nations they often confuse this accounting mechanism with the actual transfer. How is it possible for a donor to pay for the recipient's local costs (wages, housing, lumber, etc.) with the donor's currency? Simply by allocating so much more money to a specific project to cover local costs will not work. Workers in the recipient nation cannot eat the donor's currency; they cannot sleep in it; it is in fact worthless to them. The currency only represents the donor's goods and services which do not exist in the recipient nation. The only value that currency has to the recipient is in the form of foreign exchange. The local costs are not covered by this transfer and the recipient will have to devote part of its own resources to cover local costs arising out of that project. This can happen in two ways.

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[5] "Statement by the Honourable Allan J. MacEachen, Secretary of State for External Affairs and Minister Responsible for the Canadian International Development Agency, to the Standing Committee of the House of Commons on External Affairs and National Defense, April 10, 1975" (Ottawa: CIDA), p. 1.

First, the recipient can allocate part of its own scarce development resources. Second, it can create the money needed to finance the local content which would then be inflationary. This transfer problem stems directly from the confusion of the currency value of aid and the real value of aid. There is no method by which a donor can directly finance the local content of an aid project with its own currency and/or resources. This transfer problem will be raised again when the question of aid-tying is considered.

Aid in the form being examined in this study had no significant precedent before the Marshall Plan because it has come to denote some form of direct benefit to the recipient. One would be hard put to defend military assistance as a form of foreign aid. In effect, foreign aid (since the Marshall Plan) has come to mean economic assistance for the economic benefit of the recipient.

> In the history of diplomacy, subsidies and tributes have been common, and wartime aid among allies was already given by Britain during the eighteenth century and the Napoleonic wars, but peacetime economic aid among governments is novel.[6]

Milton Friedman[7] attempts to defend military

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[6] Gorin Ohlin, Foreign Aid Policies Reconsidered (Paris: Development Research Centre, OECD, 1966), p. 9.

[7] Milton Friedman, "Foreign Economic Aid: Means and Objectives," in Foreign Aid: Selected Readings, ed. by Jagdish Bhagwati and Richard Eckaus (Middlesex: Penguin Books Ltd., 1970), pp. 63-78.

assistance as an indirect form of economic assistance. Friedman basically argues that military assistance frees that portion of the recipient's budget, which would have been allocated to defense in any event, for the purpose of economic development. This argument fails for two reasons. First, Friedman overlooks the fact that the intention of both the donor and the recipient was military and not economic. Second, the argument assumes that the military assistance, ceteris paribus, replaces, not adds to, the allocation which the recipient would have made for defense in the event the assistance was not forthcoming.

Foreign aid, then, broadly means economic assistance for the economic benefit of the recipient. As pointed out earlier, however, not all economic assistance is aid.

> The central pitfall is the word "aid" itself, which by analogy with personal relationships, implies not only benefit to the recipient but a degree of sacrifice by the donor. In reality, most of what passes for aid under present international definitions brings some return to donors. . . . A first clarification demands therefore that the ambiguous general use of the word "aid" be dropped in favor of a descriptive phrase like "capital flow" or, as DAC /Development Assistance Committee of OECD/ puts it more precisely, the "flow of official long-term financial resources." Aid could remain as popular shorthand for general notions assistance; but in its technical sense, it might more aptly be limited to covering grants and what DAC calls "grant-like loans."[8]

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[8]Keith Spicer, A Samaritan State? External Aid in Canada's Foreign Policy (Toronto: University of Toronto Press, 1966), pp. 41-42.

Dr. Spicer recommends that the problem of defining the term "aid" be disregarded and that the DAC criteria be accepted instead. Far from alleviating the problem, Dr. Spicer's suggestion only serves to compound it. It was, in fact, this type of equivocation between incomparable transfers which gave rise to the problem in the first place. DAC acknowledges the problem and seeks to substitute its own terms of reference rather than attempt a solution.

> No fully satisfactory definition has ever been given to this term [foreign aid]. Normally it is used in this Report to denote only the flow of government grants and official lending exceeding five years and contributions to multilateral agencies from official sources. These flows all represent resources or purchasing power made available by donor countries to less developed countries, though they may differ widely in their terms and conditions under which they are provided. While it may be debatable whether such funds should equally all be called aid, there is hardly any doubt that they would not be available to the recipients in normal commercial channels <u>on the same terms</u> and conditions and for the same purposes.[9]

The crucial problem with the DAC approach is the phrase "on the same terms." The difference between an aid transaction and a commercial transaction is not a matter of degree (<u>i.e.</u>, the terms of the transaction) but rather a matter of kind. If, for example, a bank lends money at a 6% interest rate and a government lends the same amount at

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[9] <u>Development Assistance: Efforts and Policies, 1963</u> (Paris: Development Assistance Committee, OECD, 1964), p. 21; emphasis added.

5-3/4% interest, is the latter aid while the former is not? Both provide economic assistance and both promote the economic development of the recipient. The aid component is the difference between the two arrangements but it is not equal to either. In other words, aid involves a resource transfer from the donor to the recipient. Quite simply, "aid is a gift."[10]

> /Aid/ should refer only to the value of the subsidy implicit in the total flow of resources Thus, grants of convertible currency are certainly aid to their full face value. But loans contain only an element of aid, sometimes an insignificant element. It is clearly misleading to lump these (and some other kinds of "aid") together, when assessing either cost to donors and lender or benefit to recipients. Money lenders may benefit their clients, but we do not think of them as giving aid.[11]

If this perspective is taken, one can rule out some of the existing definitions of aid. Jagdish N. Bhagwati asserts that aid consists of

> official grants and concessional loans in currency or in kind, which are broadly aimed at transferring resources from DC's /Developed Countries/ to LDC's /Less Developed Countries/ on developmental and/or income-distributional grounds.[12]

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[10]Healey, The Economics of Aid, p. 14.

[11]J. M. Clifford and I.M.D. Little, International Aid: A Discussion of the Flow of Public Resources from Rich to Poor Countries (Chicago: Aldine Publishing Company, 1965), p. 13.

[12]Jagdish Bhagwati, Amount and Sharing of Aid (Washington: Overseas Development Institute, Monograph No. 2, 1970), p. 7.

From the foregoing discussion, exception can be taken to two points in Bhagwati's definition. First, aid is not wholly the same as a "concessional loan." Only that part of the loan which is concessional can be deemed to be aid. Second, exception should also be taken to the assertion that it is sufficient grounds to term a transaction as aid, if it is "broadly aimed at transferring resources from DC's to LDC's." Transactions which involve a two-way transfer are purely commercial while only net transfers may be considered to be aid. Buyer-seller relationships and borrower-lender relationships are two-way transactions, but a donor-recipient relationship is unidirectional.

A further distinction needs to be made at this point. Commercial and aid relationships are not necessarily mutually exclusive of one another. A portion of a commercial transaction can be considered as aid depending on the terms of the transaction. If A lends B \$100.00 and expects B to repay only \$75.00 then a part of the transaction is commercial (the \$75.00 loan) while a portion may be considered as aid (the \$25.00 which is not repayable).

In 1968, Raymond F. Mikesell[13] looked at the aid

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[13]Raymond F. Mikesell, The Economics of Foreign Aid (Chicago: Aldine Publishing Company, 1968).

programme of the United States in particular and all other aid programmes in general. Mikesell defined aid as:

> A transfer of real resources or immediate claims on resources (for example, foreign exchange) from one country to another, which would not have taken place as a consequence of the operation of market forces or in the absence of a specific official action designated to promote the transfer by the donor country.[14]

Mikesell admits, however, that his definition has two specific purposes. First, he wishes to examine, as aid, government guarantees of private foreign investment. Second, he wishes to avoid any consideration ofthe donor's motives for giving aid, i.e., transferring resources.

Mikesell's first objective is in itself contradictory. If aid is a transfer of resources, then, by definition, the aid programme cannot be entirely domestic. The insurance by the U.S. government of an investment by a private company in a Third World country, takes place on two levels--first, between the private company and recipient country, and secondly between the private company and its own government. There is no necessary transaction between the two governments (although there may be). The venture is wholly commercial. If A intends to buy a car from B but first asks for insurance through C, then

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[14] Ibid., p. 194.

it cannot be asserted that there is necessarily a transaction between B and C. Mikesell goes on to point out that the U.S. government has made money on its underwriting programme.

> Not only have the guarantee programmes not resulted in a net loss to the U.S. government--in fact they have been profitable--but there is no actuarial basis for determining likely losses. . . . Moreover, barring a worldwide catastrophe, there seems little likelihood that the unpaid callable subscriptions of the U.S. government to the World Bank and the Inter-American Development Bank will be called to meet losses of these institutions.[15]

Mikesell insists (but does not substantiate) that without the U.S. government's action, private investment flows would not occur. This is a doubtful proposition in view of the apparent return on private investment in some developing countries. There appears to be no grounds for the consideration of a government's subsidization of its domestic industry's foreign investments as critical to that flow, which is in any event, commercial and not aid.

The second consideration in Mikesell's definition is the pragmatic attempt to avoid any consideration of the donor's motives for giving aid. While one might sympathize with Mikesell's attempt to disregard this thorny problem, no definition which excludes this aspect could be considered adequate.

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[15] Ibid., p. 205.

A distinction should be made between primary motivation and secondary motivation. Primary motivation refers to the broad purpose for giving foreign aid--to promote the economic development of the recipient. Secondary motives involve a plethora of smaller concerns --political gain, stimulation of the domestic economy, *et cetera.* Secondary motivation may or may not be detected in aid transfers while the promotion of economic development or the primary motive must be present if the transfer is to be deemed as aid. The heated controversy of the 'sixties as to the motives for giving aid was fruitless because it tried to match aid only to secondary motives. It is my contention that primary motivation arises only from humanitarian considerations and that specific motives are then attached to aid transfers.

> None of the arguments from self interest (political, military and economic) of advanced countries, that had been used from time to time in support of official aid giving, was at all persuasive; the prime case for aid [has] to be made in terms of moral obligation of rich to poor, and [is] only as strong as that sense of moral obligation.[16]

All definitions of aid have one thing in common in that reference is made to the official transfers of resources. The reason for this is to identify the unit of analysis for aid. "Official" refers to the governments,

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[16] H. G. Johnson, *The Crisis in Aid and the Pearson Report* (Edinburgh: University of Edinburgh Press, 1970), p. 6.

either singularly or collectively, of the nations involved. Private flows and the actions of non-profit organizations, while certainly necessary to the overall development process, are not factors in the consideration of aid programmes.

> /Private flows/ are prompted by commercial considerations, resulting in profit to the investors involved. The fact that they are generally of benefit to the recipient (or "host") LDC's put them in the same category as international trade: trade is also beneficial to all parties to the transaction but it is not aid. Therefore, just as neither exports of LDC's to the DC's are not considered to be aid to the LDC's, nor are imports of LDC's from DC's considered to be aid to the DC's, it makes no more sense to consider private commercial flows of capital to be part of foreign assistance to LDC's. The key question is really what official assistance, or what "governments" add to the total resource flow as a conscious supplement to the resources available to the LDC's.[17]

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[17] Bhagwati, Amount and Sharing of Aid, pp. 2-3.

CHAPTER 2

THE MEASUREMENT OF FOREIGN AID

As previously mentioned, official programmes are extremely heterogeneous in character.[1] No specific record of aid flow, as defined in this study, can directly be referenced in order to determine the magnitude of these flows.

> For a variety of economic reasons the official measurement of aid transfers grossly [overstates] the amount of real resources transferred by aid-donors to aid-recipients and received by aid-recipients from the aid-donors--the two magnitudes [are] not necessarily even approximately the same.[2]

Referring to Barbara Ward's assertion that "aid has long since ceased to be a giveaway programme," Gerald Helleiner points out that "what is today statistically recorded as aid and served up for our selfcongratulation and the applause of the recipients, however, is something quite different from the concept of

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[1]See Chapter 1, p. 8.

[2]H. G. Johnson, The Crisis in Aid and the Pearson Report (Edinburgh: University of Edinburgh Press, 1970), p. 6.

a giveaway."[3] It is the purpose of this study by means of previous definition, to examine what Helleiner calls "the giveaway" or what is referred to here as the "unidirectional transfer."

When analysing official flows it is necessary to construct a continuum on which the different types of flows can be placed.

FIGURE 1

The Aid Continuum

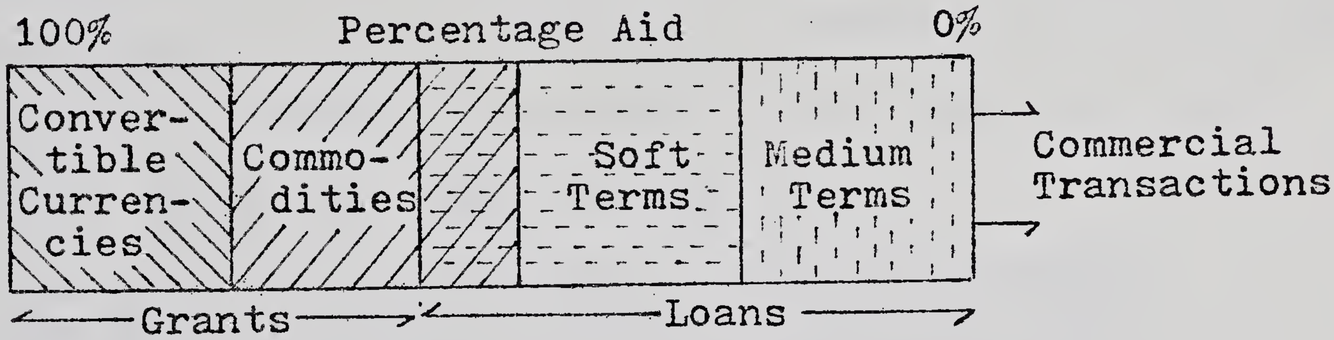

Figure 1 demonstrates that as the transaction moves from left to right on this continuum, the percentage of the nominal value of that transaction which can be deemed to be aid correspondingly decreases. There is a distinction made between grants-in-currency and grants-in-kind. This separation will be explained when the question of aid-tying is considered. The stipulation of the aid component of the loans portion of the continuum presents an immediate problem because the terms under which loans are made vary.

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[3]Gerald Helleiner, "The Development Business: Next Steps," International Journal, XXV (Winter, 1969-70), p. 162.

> Aid is the real cost of providing a loan, and the real cost of resources lent or given is the benefit foregone by not using them in their best alternative use.[4]

Two considerations arise concerning the foregone benefit: the grant equivalent element of the loan, and the opportunity cost of the resources involved.

The grant element may be defined as "the difference between the face value of a loan and the present value of the future repayments (amortization and interest payments) discounted at proper rate of interest."[5] The mathematical calculation of this is outlined in Appendix II of this study. The purpose of such a calculation is to reduce all loans to their equivalent value in grants.

> The discounting procedure is used to calculate the present value of all future payments (and receipts, where the loan may specify that part of the proceeds which will become available to the donor in the future) in order to obtain an equivalent value for the loan. The object is to find that grant, which, if made available in the present, would be the exact equivalent of the loan, after account has been taken of the future charges which must be met on the latter. These future charges (net), when discounted, are compared with the face value of the loan and the difference, when expressed as a percentage, is known as the "grant element" of the loan.[6]

In Figure 1, the continuum ranges from 100% grant equivalent

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[4]J. M. Healey, The Economics of Aid (Middlesex: Penguin Books Ltd., 1971), p. 15.

[5]Gorin Ohlin, Foreign Aid Policies Reconsidered (Paris: Development Centre of the OECD, 1966), p. 101.

[6]E. K. Hawkins, The Principles of Development Aid (Middlesex: Penguin Books Ltd., 1970), p. 31.

on the left, to 0% (commercial terms), on the right. Some argument has arisen over the rate of discount to be employed when calculating the grant equivalent of loans.

> The logic behind discounting is that future payments and receipts are worth less than those in the present; money available now can be invested at the rate of return obtainable in the economy [of the donor], so the discount rate chosen should be equal to the highest rate of return available for such funds.[7]

The "highest rate of return," however, is contingent on a number of assumptions. If a domestic rate is to be used, should the public bond rate be chosen over the rate available to the private investor? Should the rate of discount be standardized to that of one international organization or should the rate be adjusted to the highest rate on the world market (*e.g.*, the U.S. or Japanese rate)? Exactly what rate should be chosen is debated even among economists.[8] The Annual Report of the DAC employs a discount rate of 10%.[9] This reflects the assumed average return in the capital markets of the member countries. Raymond Mikesell argues that the discount rate should "reflect the relative scarcity of capital in the [donor] country, or the marginal rate of return on investment *plus*

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[7] *Ibid.*, p. 32.

[8] Jagdish Bhagwati, *Amount and Sharing of Aid*, (Washington: Overseas Development Institute, 1970), Monograph No. 2, p. 14.

[9] *Development Assistance, 1968* (Paris: Development Assistance Committee, OECD, 1969), p. 2.

the risk premium."[10] Mikesell later equates the discount rate with the "social rate of return on capital in alternative employments in the donor country."[11] He also states that this social rate of return is well above the interest rates in capital markets and points to figures of between 15 and 20 per cent. This piece of economic sophistry demonstrates why the "subject of aid, like development itself, belongs to political economy rather than economics proper."[12] The economic argument as to the discount rate to be employed overlooks the fact that the funds being analyzed are public funds. Assumptions concerning private markets or private investment opportunities are therefore irrelevant. No government will invest public funds in second mortgages or establish a high yield/high risk finance corporation. The previous definition of aid refers to "official flows" and the discount rate must then reflect "official alternative employments of capital."

John Pincus pioneered the grant equivalent approach in a report prepared for the Second United Nations Conference on Trade and Development (UNCTAD).[13] Pincus employed

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[10] R. F. Mikesell, <u>The Economics of Foreign Aid</u> (Chicago: Aldine Publishing Company, 1968), p. 133; emphasis added.

[11] <u>Ibid</u>., p. 227. A social rate of return takes account of all monetary and non-monetary effects (multipliers, <u>etc</u>.) resulting from investment.

[12] Hawkins, p. 11.

[13] John Pincus, <u>Economic Aid and International Cost</u>

three separate discount rates in his calculations. The first was the domestic long-term interest rate in the donor country. This rate, said Pincus, was reflected by mortgage rates or the long-term government rate plus one per cent. The second rate Pincus used was the International Bank for Reconstruction and Development's (IBRD) borrowing rate. The purpose of this rate was to reflect donor cost, had multilateral rather than bilateral channels been used. This rate is lower than the domestic rate at that time and was approximately equal to six per cent.[14] The third rate of discount employed was the rate of return which private investors in the donor country might have required. This is the previously mentioned OECD figure of 10 per cent. Employing OECD figures for the period from 1962 to 1966, Pincus arrived at the figures in Table 1. The degree to which different interest rates can affect the grant equivalent value of a loan is represented graphically in Figure 2.

The employment of the 10 per cent (private investment) discount rate can be seen to be inappropriate because the funds in question are public. The reason that such figures are often used is that the employment of a higher

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Sharing (Baltimore: Johns Hopkins Press, 1965).

[14] I.M.D. Little and J. M. Clifford, International Aid: A Discussion of the Flow of Public Resources from Rich to Poor Countries (Chicago: Aldine Publishing Company, 1965), p. 73.

TABLE 1

GRANT EQUIVALENT OF LOAN COMMITMENT OF 13 DONORS

WITH DIFFERING DISCOUNT RATES

	1962	1963	1964	1965	1966
Donors' Domestic Interest Rate	590.0[a] (21.7)[b]	726.0 (25.2)	1,050.0 (28.5)	624.3 (20.6)	993.0 (28.1)
IBRD Borrowing Rate	244.8 (9.0)	823.7 (11.2)	565.6 (15.4)	304.7 (10.5)	833.4 (25.6)
10 Per Cent	1,298.3 (47.8)	1,438.8 (50.0)	1,990.8 (54.1)	1,308.7 (43.2)	1,708.2 (48.8)
Nominal Value of Loan Commitments	2,714.5	2,877.2	3,681.9	3,027.0	3,553.9

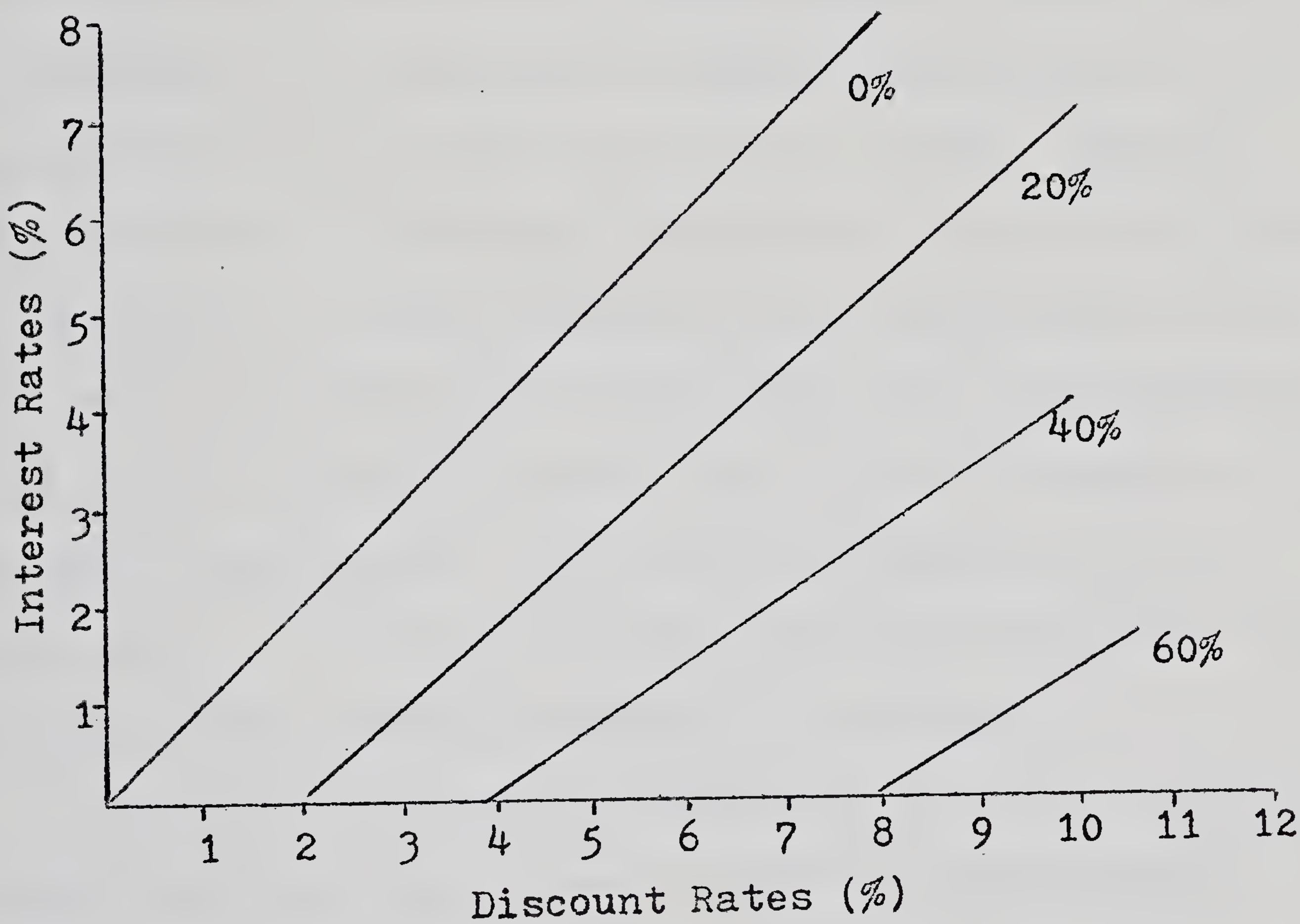
SOURCE: John Pincus, Economic Aid and International Cost Sharing, p. 136.

[a]$ millions (U.S.A.)

[b]Percentage of nominal value in parentheses.

FIGURE 2

Combinations of Interest Rates and Discount Rates with Same Grant Element (%)



SOURCE: E. K. Hawkins, The Principles of Development Aid, p. 36.

rate maximizes the differential between the discount rate at the nominal rate of interest and therefore, by definition, enlarges the grant equivalent element of the loan. This type of equivocation between the public and private sectors, to use Gunnar Myrdal's words, "deviates from the truth in an opportunistic direction."[15]

The second form of discounting, the use of the IBRD's borrowing rate, also ignores certain public realities. The government of a developed country cannot borrow from that institution to raise the required funds. Further, funds forwarded to the Bank, which form international credits, are unlikely to be called upon by the contributing government. The funds provided to the IBRD, from the perspective of the donor, cannot be looked upon as an investment or an investment opportunity. This rate of discount would be applicable to an analysis of the recipients' benefits (such as Pincus') but cannot be applied to the donor.

The final alternative discounting rate, the donor's domestic interest rate, comes closest to representing alternative employments of public capital. A government can raise capital in basically three ways: taxation, increasing the money supply and borrowing. The funds to which this analysis is addressing itself cannot be generated by increasing the money supply since the measure must

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[15]Gunnar Myrdal, Against the Stream: Critical Essays on Economics (New York: Vintage Books, 1975), p. 158.

ultimately be reduced to real resources, not money.[16] A government borrows capital by issuing long-term government bonds for which it pays subscribers a given rate of interest. This interest, plus the cost of issuing the bond (printing, accounting, etc., or approximately one per cent), may be said to be equivalent to the alternative uses of public capital. If the government had not used these funds for the transfer of resources to developing nations, it could have bought back or retired previous (or current) bond issues.

The final alternative, taxation, withholds from the private sector a fixed amount of capital for investment. The distinction must be made again between government and private investment. The government, after having taxed the private sector, wholly controls the capital assets. To discount at the private rate of interest ignores the explicit transfer to the public sector and would amount to double counting the capital stock. These funds could be used by the government to retire or buy back the same bond issues (i.e., reduce the public debt) mentioned in the previous example. The rate of discount would still be the long-term government bond rate. In fact, given the narrow alternatives open to a government, it is the contention of this study that this is the best alternative usage of

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[16] Inflation is controlled for by analyzing flows as a percentage of the gross national product at market prices.

public funds and therefore the most reasonable discount rate.

One further issue remains regarding the matter of the discount rate to be employed in computing the grant equivalent of international development loans. Clifford and Little contend that 15 per cent is also an allowable discount rate.[17] The rationale used to justify this extraordinarily high figure is that "some allowance for the probability that many of these loans will not be repaid as scheduled" must be made.[18] This assertion is truly absurd. This approach strikes at the immediate core of the issue by begging the question "why tender the funds in the form of a loan in the first place?" The point of the exercise is to establish empirically what portions of the loan in fact amount to a unidirectional transfer. The remainder is exactly the same as a commercial loan within the donor economy.

> Banking is not commonly regarded as a charitable activity, no matter how useful its services. A repaid loan on commercial terms is not considered a loss, and such benefits as the borrower derives from it he also pays for. Development banking, like all forms of banking, serves to reduce risks by improving the organization of the capital market and thus improve the terms upon which credit is available.[19]

If the entire transaction is to be discounted in the first place, *i.e.*, compared to other commercial transactions,

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[17] Clifford and Little, p. 73.

[18] *Ibid.*

[19] Ohlin, p. 90.

then to change the premises in the midst of analysis, to rediscount, compounds questionable policy with bad economic analysis.

Perhaps the greatest attraction of this method of measuring aid (the grant equivalent approach) is that the reverse flow, repayments of interest and principal, from recipient to donor, is accounted for in a single calculation. In fact, to deduct the reverse flow of LDC's to DC's, having already calculated the present value equivalent of all future repayments of principal and interest, would be a form of double counting.

A numerical example should illustrate the principles involved. Assume $1,000 is lent for a period of 20 years at five per cent interest and a five year grace period is allowed before repayment of principal begins. The present value of the future payments of interest and principal, employing an eight per cent discount rate, is approximately $760. The loan then has the equivalent value of a grant of $240. (The nominal value of the loan less the present value of future repayments.) As a percentage of the face value of the loan, the grant equivalent is approximately 24%. Now assume that the same loan ($1,000) is extended for a period of 50 years, at 3/4% interest, with a grace period of 10 years. Employing the same discount rate of eight per cent, the present value of future repayments is approximately $210. The grant equivalent of this loan is

$790 or 79% of its face value. Thus, varying the terms under which the loan is offered can substantially change its grant equivalent value without altering its face value. This situation has been represented graphically in Figure 3. All points on the given isogrants represent different combinations of terms yielding the same grant equivalent value. Further, it should be noted that the grant equivalent is much more responsive to changes in interest rates than to changes in maturity.

The grant equivalent approach offers a method by which economic apples and oranges (grants and loans) can be added together and thereby analyzed. Unfortunately, the aid programmes of the developed countries also contain a wide variety of other fruits which must similarly be reduced before the analysis can proceed. A further problem arises when grants and/or loans-in-kind (development prunes) are considered. The question of aid-in-kind is inextricably linked to the question of aid-tying.

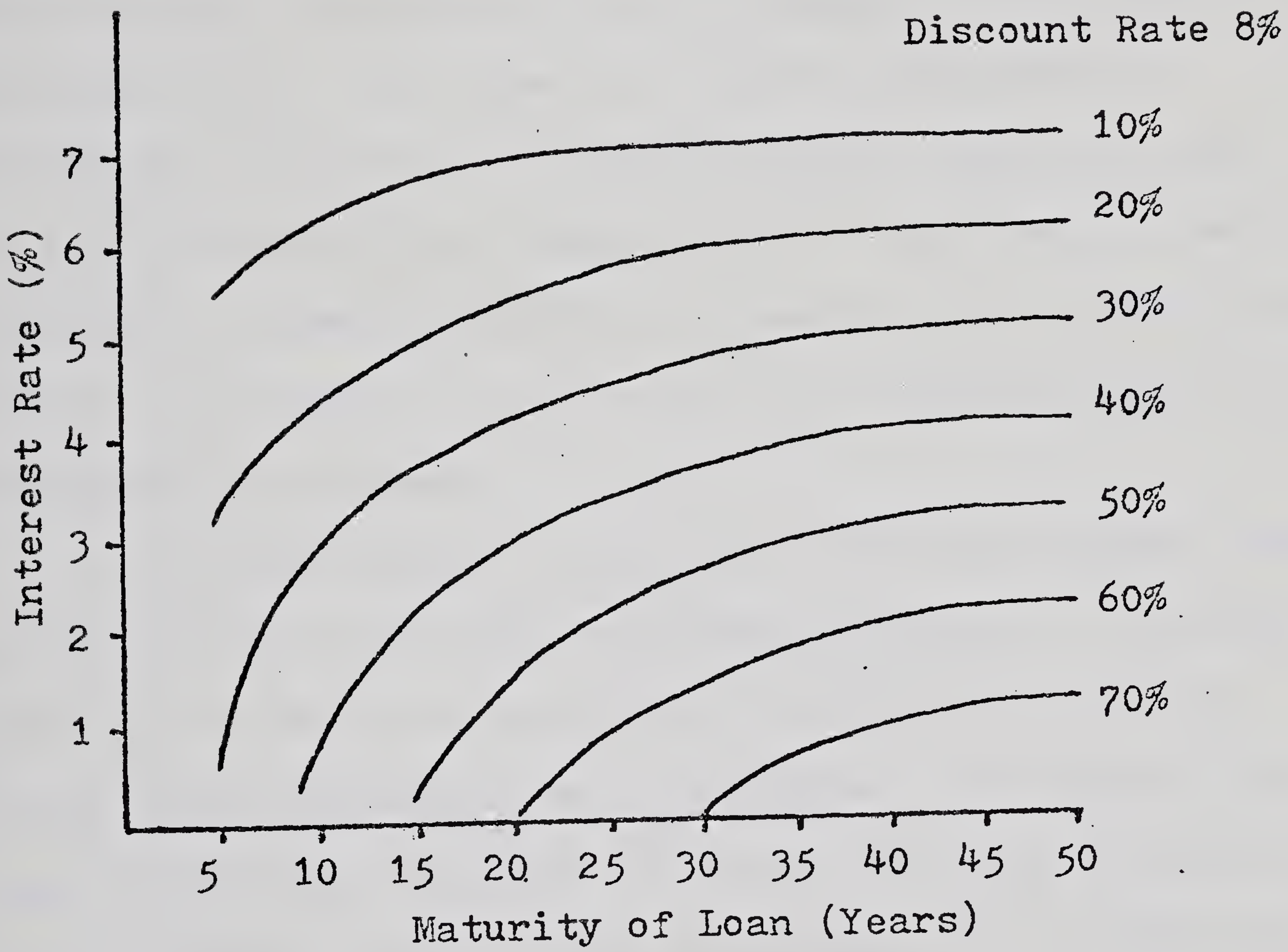
There are two ways in which aid can be tied: by procurement and by project. Procurement or source-tying means that aid funds must be spent in the donor country. Project tying specifies that the funds are to be used on only certain items within the donor country.

> The provision of aid in its present predominantly bilateral and project-tied form involve certain inefficiencies that reduce its effectiveness and usefulness to the recipients by reducing the real value of the resources it transfers and restricting

FIGURE 3

Combinations of Loan Terms with Same

Grant Element (%)



SOURCE: E. K. Hawkins, <u>The Principles of Development Aid</u>, p. 37.

the uses to which it may be put.[20]

Aid-in-kind creates a problem because the domestic cost of the resources transferred may differ substantially from the world market price for that commodity. The basic question becomes whether to value such aid at domestic or world prices.[21] Such discrepancies will arise if the donor is not the most efficient producer of the goods involved in the aid transfer. If, for example, an Australian aid project required machine lathes and West Germany produced these lathes at the lowest cost, then the difference between Australian lathes and West German lathes must be accounted for before the aid transaction can be meaningfully analyzed.

It was pointed out earlier that the transfer should not be confused with the accounting mechanism. In other words, it is the real resources involved and not their dollar value which must be investigated. As long as the donor is transferring real resources the nominal value of those resources is of little importance. If a given aid transaction involves the transfer of one hundred tractors, the transfer should not look at the one million or two million dollars at which the transfer is valued.

To argue, as some developing nations have, that

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[20] H. G. Johnson, Economic Policies Toward Less Developed Nations (Washington: Brookings Institute, 1967), p. 80.

[21] Pincus, p. 131.

had one and a half million dollars (domestic price) been transferred instead of one million dollars (world prices), more tractors would have been received, is to confuse money with the transfer of real resources (tractors). The donor has transferred one hundred tractors and this is the amount of aid involved. The other fifty tractors (the difference between donor price and world price) does not alter the aid transfer.

The situation just stated relates to grants-in-kind. Grants by definition are wholly equal to the aid transfer. No adjustment is necessary because when this transfer is compared to the donor's gross national product (GNP) the amount of sacrifice (percentage of GNP) accounted for by the aid programme will be the same as the same transfer made by the most efficient producer. Not all commodity transfers are grants.

When commodity transfers take the form of loans, the analysis can no longer be confined to the donor economy because the recipient must repay the donor for the commodity involved. In this case, the recipient may very well be penalized by the donor's inefficient production. In the example used above, the donor would be asking the recipient to pay for fifty tractors which it did not receive. Because there is a reverse flow from recipient to donor, the overall relationship must be evaluated. Having taken out the grant equivalent of the loan, the residual

amount must then be compared with the world price for the commodity involved. This would then serve to reduce the real resources transfer because netting out the excess cost would reduce the grant element of the loan. The difference between the domestic price and the world price is, in effect, not aid, but rather a government subsidy to inefficient domestic production.

> A more efficient solution would be the element of excess cost imposed by tying [in the case of a loan] to be given in the form of a grant and charged to some domestic expenditure account (as export promotion, domestic transfer, or domestic production subsidy) rather than against the foreign aid program.[22]

This approach would redress the imbalance caused by the reverse flow. The grant equivalent of the loan would therefore return to its original value. The additional grant could not be counted as aid because it only replaces the subsidy originally provided by the recipient.

Another set of considerations arise out of the method of tendering aid projects. It is very possible that producers in the donor country, realizing the freedom of action of the recipient country in employing tied funds, will use their monopolistic advantage (either singularly or collectively) to raise their prices much higher than would be possible in a competitive market.

> The worldwide tendering on projects, which are then ostensibly assigned to different tied sources according to the successful tenders, will not

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[22] Johnson, Economic Policies, p. 125.

> necessarily yield the maximum number of bids and the widest, most competitive quotations to choose from. If there is a preponderance of tied funds from one source alone, and the free foreign exchange of the recipient is negligible in comparison, then suppliers from areas other than the tied-aid sources may not deem it worthwhile to tender at all. Further, if suppliers from the preponderant tied-aid source know about this limited flexibility, then their tenders may well reflect this monopoly position.[23]

This is a refined way of saying that suppliers in the donor economies are not above "price gouging" if given the chance. Until and unless aid funds are untied by donor governments, careful scrutiny of bidding practices should be maintained to avoid both donor and recipient governments falling victim to such practices.

The above discussion on commodity aid and tied aid has assumed that the factors of production in the donor economy are fully employed. If the factors of production in the donor country are not fully employed or are immobile, then the opportunity cost of resource transfers is lower. In the extreme case where factors have no alternative employment, the opportunity cost is zero. It is important, however, not to confuse opportunity cost for the donor with the value of the resource transfer. If a certain commodity is truly a surplus in the donor economy (wheat, for example), this is not to say that it has no value as aid. The

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[23]Jagdish Bhagwati, "The Tying of Aid," in <u>Foreign Aid: Selected Readings</u>, ed. by J. Bhagwati and R. S. Eckaus (Middlesex: Penguin Books, 1970), p. 256.

commodity may be very valuable to a recipient in whose economy that commodity is scarce.

> The disposal of accumulating surpluses such as grains may even save resources, if it reduces the need to build new silos to accommodate further surpluses. While cheap to the donor, the surpluses may none-the-less be worth a great deal to the recipient. There is thus, no symmetry in the "costs" to the donor and the "benefits" to the recipients when surplus commodities are transferred.[24]

In order to evaluate surplus commodity transfers it is necessary to return to the original definition of aid. Two questions must therefore be answered. Is this a transfer of real resources? Certainly. Is this intended to contribute to the economic development of the recipient? This second question is more difficult to answer and requires further analysis.

If a commodity is surplus in the donor's economy it could still have a world market price.[25] If other nations are willing to trade their goods or to buy the commodity which is surplus in the domestic economy, then that commodity has a market value, i.e., the world market price. When the commodity is used as aid, two considerations arise if it has a world market value. First, if there is strong demand for the commodity internationally,

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[24]Bhagwati, Amount and Sharing of Aid, pp. 8-9.

[25]Very few commodities are truly surplus and the discussion refers to a "declared surplus" which is removed from the confines of the domestic market.

then the donor is foregoing its world market value by using it as aid. In view of the previous definition, this sacrifice is insufficient to qualify the transfer as aid. The question is not whether there is a demand internationally, but rather whether there is an economic demand for the commodity within the recipient economy. The second consideration, the recipient's need (demand), is the most important consideration in determining whether the transfer is aid. If there is a demand for the commodity in the recipient country, then the transfer will be developmental. If there is no demand for the commodity in the recipient economy, then the transfer is not developmental and could well be detrimental to that country's development. If a recipient country is not lacking in agriculatural production then the transfer of surplus food grains can harm that economy by decreasing the marginal utility of its food production. The added grain in this case could drive down the price of domestically produced food and thereby provide a disincentive toward further production. While it is not the purpose of this study to examine the domestic policy of the donor which gives rise to such surplus commodity transfers, it should be noted that that policy is in all probability economically inefficient.

> Aid in the form of surplus agricultural products reduces the incentives [for the recipients] to increase productivity in agriculture (which tends anyway to be starved of investment resources by planners interested in industrialization) even though it is the largest, and an obviously back-

> ward sector in the less developed countries. For the donors the giving of aid excuses the maintenance or adoption of commercial and domestic economic policies that restrict the opportunities for less developed countries to develop on the basis of exporting to their rich and growing markets. Aid in the form of agricultural surpluses enables a domestic problem to be shifted to the world market under the guise of charity. In short, the giving and receipt [of surplus commodity] aid permits both parties to avoid harder choices involving the conflicts between the requirements of economic efficiency and other objectives of economic policy.[26]

A commodity surplus, such as those under Public Law 480 in the United States, may be intended to subsidize the domestic economy and may have little or no intention with regard to the economic development of the recipients of such surpluses. Section (2) of the Agricultural Trade Development and Assistance Act (1954) or P.L. 480[27] states:

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[26] Johnson, Economic Policies, pp. 3-4.

[27] P.L. 480 is divided into four sections:

1. Type I provides for commodity sales for local (recipient) currency:
2. Type II provides surplus agricultural commodities for use in emergency assistance;
3. Type III provides surplus agricultural commodities for voluntary agencies (e.g., CARE);
4. Type IV provides agricultural commodities for long-term dollar credits.

Types II and III could be considered as aid under the present definition but types I and IV (which are by far the largest) are commercial transactions which in no way can be considered to be aid. See Mikesell, pp. 184-93; Clifford and Little estimate that the net contributions of P.L. 480 (i.e., flow of resources to the LDC's) amounted to only 20% of face value of the programme in the years 1962-63 (p. 166). An excellent analytical treatment of P.L. 480 can be found in Alexis E. Lachman, The Local Currency Proceeds of Foreign Aid (Paris: Development Centre of the Organization for Economic Cooperation and Development, 1968).

> It is hereby declared to be the policy of Congress to expand international trade among the United States and friendly nations, to facilitate the convertibility of currency, to promote the economic stability of American agriculture and the national welfare, to make maximum use of surplus agricultural commodities in furtherance of the foreign policy of the United States, and to stimulate and facilitate the expansion of foreign trade in agricultural commodities produced in the United States by providing a means whereby surplus agricultural commodities in excess of the usual marketing of such commodities may be sold through private trade channels, and foreign currencies accepted therefore. It is further the policy to use foreign currencies which accrue to the United States under this Act to expand international trade, to encourage economic development, to purchase strategic materials, to pay United States obligations abroad, to promote collective strength, and to foster in other ways the foreign policy of the United States.[28]

Very little in this Act suggests that its intention is to contribute to the development of the recipients. The Act refers to counterpart funds in the United States which _may_ be used to encourage economic development. The use of these counterpart funds to promote economic development is certainly aid but the entire P.L. 480 programme does not meet the criteria of the definition. The magnitude of this problem can be seen in the fact that P.L. 480 accounted for 31% (or $1.5 billion) of the 1967 U.S. aid commitments and 18% of the total flow of official bilateral assistance reported by DAC.[29]

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[28] Quoted in C. R. Hensman, _Rich Against Poor: The Reality of Aid_ (Harmondworth: Penguin Books, 1975), p. 254.

[29] _Partners in Development: Report of the Commission on International Development_, L. B. Pearson, Chairman (New York: Praeger Publishers, 1967), p. 152.

The purpose of this Chapter has been to establish some "ground rules" for the following case study. Chapter 1 was used to provide a clear conception of what is and what is not aid. This Chapter has provided the background and the tools required for the case study.

CHAPTER 3

THE HISTORY OF CANADIAN FOREIGN AID

Concessional economic transfers by Canada are unique to the post 1945 period. At the end of the Second World War, North Americans began to be concerned with the damage sustained by Britain and our European allies. Because Britain had accounted for a considerable portion of Canadian trade prior to the outbreak of war, the Canadian government was anxious to re-establish these markets. During the period from 1945 to 1950 Canada's contributions to programmes such as the Marshall Plan and the United Nations Relief and Rehabilitation Agency (UNRRA) amounted to over two billion dollars.[1]

The definition of aid used by this study would not classify the above contributions as foreign aid. These programmes were intended to rebuild rather than develop the

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[1]Keith Spicer, A Samaritan State? External Aid in Canada's Foreign Policy (Toronto: University of Toronto Press, 1966), p. 252; this figure includes $271 million in grants and $1,767 million in loans. Over half of the total amount or $1,185 million was loaned to the United Kingdom.

damaged economies of Europe. Clearly there is a vast difference between a programme of repairing an existing structure and one that builds the entire structure. For example, the physical and human infrastructures which existed in Britain in 1945 were already developed whereas in most developing countries virtually no infrastructure, physical or human, existed prior to the initiation of the development process. Although there have been attempts made to trace the beginning of foreign aid to 1945,[2] for the purposes of this study foreign aid did not commence until 1950.

Canadian aid, as it is defined in this study, begins in 1950 with the Colombo Plan. Canada's original contribution was $25 million.[3] The Colombo Plan was initially a Commonwealth sponsored programme focused primarily on South-East Asia. The term "plan" is somewhat misleading as no specific plan was formulated nor was there anything established by the agreement which could function as a planning mechanism. The Colombo Plan, as with most Commonwealth

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[2]See Gorin Ohlin, Foreign Aid Policies Reconsidered (Paris: Development Research Center, 1966), p. 9; also see John White, The Politics of Foreign Aid (London: The Bodley Head Ltd., 1974), pp. 198-203.

[3]"Canada and the Colombo Plan," A Statement by the Secretary of State for External Affairs, L. B. Pearson (Canada, House of Commons Debates, 21 February 1951, pp. 537-8); excerpt reprinted in R. A. MacKay, ed., Canadian Foreign Policy, 1945-1954: Selected Speeches and Documents (Toronto: McClelland and Stewart Ltd., 1971), p. 369.

programmes, can best be described as a form of consultative-bilateralism.[4] The Plan was originally seen as a six year commitment by the participating governments but has grown and expanded to become the present Canadian aid programme.

At the time the Colombo Plan was being formulated, there was no perceived difference between rebuilding in Europe and the developmental problems of South-East Asia. The Marshall Plan was, by general consensus, extremely successful. In retrospect, one can see how this inability to distinguish between reconstruction and development gave rise to misplaced expectations and later to unwarranted criticism of the supposed failure of programmes such as the Colombo Plan. The basic premise of the Marshall Plan was the infusion into an economy of vast amounts of capital over a short length of time. The Marshall Plan followed this approach while the Colombo Plan did not. John White points out that the average annual per capita receipts under the Marshall Plan amounted to about $12, mostly in grants (or about $20 at 1970 prices), while the average annual per capita receipts for the developing countries in the period 1968-70 amounted to only $4.38, of which the bulk was in the form of loans.[5]

The Colombo Plan derived much of its original impetus from the Cold War. The primary motive of the scheme

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[4]Spicer, p. 71.

[5]White, p. 200.

was development while the underlying or secondary motive was combating the spread of communism. Lester B. Pearson in an address to the Canadian Conference on Aid to Underdeveloped Countries in 1955 made a similar distinction regarding the dual motivation of the Colombo Plan.

> We should ask ourselves from time to time whether we would be doing what we are if the political and military menace of Soviet and Chinese communism did not exist. It sometimes seems to me that we in the West come near to owing at least one debt of gratitude to international communists--and we have precious little to thank them for over the past few years--for helping us to keep up to the mark in these matters. It is a sorry commentary on the post-war period that without them and the threat which they represent we might not so readily have done what we should have been doing anyway.[6]

The history of Canadian aid from 1950 to 1965 has been well treated elsewhere and the following brief discussion borrows heavily from that study.[7]

Following the Colombo Conference in January, 1950, the Canadian government set up an interdepartmental group chaired by External Affairs, and represented by concerned departments such as Finance, Trade and Commerce, Labour, Agriculture, Mines and Technical Surveys, National Health and Welfare as well as the Bank of Canada. The group called itself the Interdepartmental Group on Technical Assistance (IGTA). The main inputs to this committee came from

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[6]Quoted in Spicer, p. 22.

[7]Spicer, pp. 93-119.

External Affairs, whose primary concern was with the broad control of aid policy as it related to the overall direction of Canada's foreign policy. Trade and Commerce took general administrative control of the fledgling programme.

A special agency was established by IGTA to administer what was at the time considered to be a temporary programme. The new agency was called the International Economic and Technical Co-operation Division (IETCD) and was housed in the Department of Trade and Commerce. Nik Cavell, a private industry executive with experience in Asia, was appointed as administrator of the new agency. The agency initially consisted of Mr. Cavell and three or four officers from Trade and Commerce.[8] The IETCD began functioning in 1951 and continued until the appointment of Mr. Cavell as High Commissioner to Ceylon in 1958. The agency was given general responsibility for technical and capital assistance programmes under the Colombo Plan, although actual policy decisions remained the responsibility of IGTA.

In 1958 IETCD was rebaptized the Economic and Technical Assistance Branch (ETAB) and Dr. O. E. Ault, a former senior officer in the Civil Service Commission was named as its director. The Conservative government of John Diefenbaker sought to expand the Canadian aid programme,

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[8] James Eayrs, The Art of the Possible: Government and Foreign Policy in Canada (Toronto: University of Toronto Press, 1961), p. 59.

but continued the Commonwealth bias initiated by the Colombo Plan. The Canada-West Indies Aid Programme (which later became the Commonwealth Caribbean Programme), The Commonwealth Technical Assistance Plan and the Commonwealth Scholarship and Fellowship Plan, were all initiated by ETAB in 1958.

In 1960, the Canadian government realized that aid could no longer be considered a short-term programme. This change was in no small way due to the creation in that year of the Organization for Economic Co-operation and Development (OECD). The OECD grew out of the former Organization for European Economic Co-operation which had been the co-ordinating body in Europe for the Marshall Plan. The Development Assistance Committee (DAC) was established by the OECD in 1961. The function of DAC is to provide a forum in which donors could "consult on methods . . . for expanding and improving the flow of long-term funds and other development assistance."[9]

The United States began in 1960 formally to press Canada and other DAC members to increase the volume of their aid to developing countries. At both the London and Tokyo meetings of DAC in 1961, the United States applied pressure on other member governments (Canada, France,

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[9] Development Assistance (Paris: OECD, 1964), p. 4.

Germany, Italy, Japan, the Netherlands, Belgium, Portugal and the United Kingdom) to bring their aid contributions to the developing nations up to one per cent of their gross national products.[10] One of the reasons why the other members might have rejected the U.S. proposal was the implied loss of sovereignty. Countries have not in the past accepted an arrangement through which they would be constrained in the formulation of their national budgets. What the U.S. was in fact proposing was an international tax.

Although the United States proposal was rejected by other members, it did in fact result in the only existing mechanism by which foreign aid policies can be compared and, to some extent, criticized. As valuable as a scrutinizing device may be in such vital areas as development assistance, neither DAC nor the OECD itself has the political power to regulate the policies of its members. The formation of DAC has, however, had a profound effect on Canadian foreign aid policy.

In 1960 the Canadian government established a unified agency to deal with foreign aid policy. The External Aid Office (EAO) was established to bring order to a previously chaotic situation. H. O. Moran, a career

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[10] John Pincus, Economic Aid and International Cost Sharing (Baltimore: The Johns Hopkins Press, 1965), p. 110.

diplomat in External Affairs, was appointed Director-General of the new agency. The EAO had what its predecessor lacked, a direct route to a cabinet minister in that the Director-General reported directly to the Secretary of State for External Affairs. The reorganization gave the Canadian programme the necessary administrative capability to cope with both the rapidly expanding programme and the new international challenge. During the period of the EAO, Canada's assistance grew from $81.9 million in 1961 to $247.9 million in 1967.[11] This period witnessed the birth of the francophone aid programme and a multilateral commitment in Latin America _via_ the Inter-American Development Bank.

Aid to francophone countries traces its origins to two significant events in the early sixties. The first of these was the "Quiet Revolution" in Quebec wherein the province began to push for a greater voice in the realm of foreign policy. Quebec pointed out quite rightly the excessive Commonwealth bias of Canada's aid programme.

> Le Commonwealth n'est pas toute l'humanité, . . . il existe des pays sous-développés où la langue de communication est le français. . . . Il y a là une question d'égalité et de justice.[12]

Canada's aid programme began with the Colombo Plan, initially

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[11]Canada, CIDA, _Annual Review, '69_ (Ottawa, 1970), p. 24.

[12]_Le Devoir_, 16 January 1960.

a Commonwealth programme, and had followed existing Commonwealth linkages thereafter. In point of fact, the Commonwealth was the only real connection Canada has had with the developing nations.

The rationale for creating a separate francophone programme is somewhat questionable. In essence the argument is based on French-Canadian nationalism and has very little to do with the recipient countries. Hopefully it is not the language spoken in a country which qualifies it to receive Canadian aid but rather some criteria based on need. There is no existing political entity in Africa which corresponds to this programme and the rationale for the programme must therefore be based upon domestic considerations. C'est questionne d'égalité et de justice et de necessité, ce n'est pas une question du langage.

The second event which gave rise to a francophone aid programme was the decolonization by France of its former possessions in Africa. France has in fact been one of the major obstacles to a francophone programme for Canada since 1960. This did not overcome the fact that these emerging nations in francophone Africa were still heavily reliant on France for the bulk of their assistance, particularly in terms of administrative infrastructure. Canadian aid personnel often dealt through French administrators in these countries during the early days of the programme. These new Canadian overtures were not at all welcomed by

the government of Charles De Gaulle. The decision to create a francophone programme also pointed out that the EAO lacked the necessary francophone personnel and that a new programme required a substantial amount of lead time before it could actually begin functioning. Some indication of the amount of lead time required to establish a functioning development assistance programme can be derived from Table 2.

TABLE 2

BILATERAL DISBURSEMENTS IN FRANCOPHONE AFRICA: 1972-1973/74

Year (Fiscal)	Amount ($ millions)	% of Total Canadian Disbursements
1962/65*	1.57	0.5
1965/66*	4.04	2.5
1966/67*	10.68	4.3
1967/68*	12.09	4.8
1968/69	14.43	10.0
1969/70	21.66	10.2
1970/71	29.70	10.6
1971/72	45.13	15.9
1972/73	59.08	17.9
1973/74	66.65	18.1

*Figures based on allocations rather than disbursements.

SOURCE: CIDA, Annual Reviews, 1969-1973/74.

A second region in which a programme was launched by the EAO was Latin America. Canada has been under pressure for some time by the United States and many Latin American countries to join the Organization of American

States (OAS).[13] Two institutions established in Latin America during the early 'sixties were the Alliance for Progress and the Inter-American Development Bank. Canada was opposed to official membership in the OAS and hence participation in the Alliance for Progress as it felt that Canadian interests in Latin America were minimal. The Canadian government did agree to participate in the IADB in 1964 with an annual contribution of $10 million. Canada forwards its contribution to the IADB which in turn loans money to Latin American countries at the IDA (International Development Association) rate of 0.75 per cent interest, a ten year grace period, and equal annual payments over fifty years. This subscription was raised to $10.5 million in 1967 and later decreased to $7 million in 1973.[14] Canada's bilateral program in Latin America did not begin until 1971 although previous Annual Reviews continued to list the IADB subscription as such.

Three events in 1968 provided the impetus for still further change in Canada's foreign aid policy. The first was Pierre Trudeau's assumption of the leadership of the governing Liberal Party. Part of the Trudeau platform was

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[13] Peter C. Dobell, Canada's Search for New Roles: Foreign Policy in the Trudeau Era (London: Oxford University Press for RIIA, 1972), pp. 116-117.

[14] Canadian International Development Agency, Annual Review, 1973-74 (Ottawa: CIDA, 1975), p. 40.

a comprehensive review of Canadian foreign policy. In a speech in Edmonton in May, 1968, Trudeau pointed out the growing disparity between the rich and poor nations and the need for increased development assistance. "The new name for peace," said Trudeau quoting Pope Paul VI, "is development."[15]

The second event was the publication of the Report of the Commission on International Development.[16] Lester B. Pearson, the former Prime Minister, was the chairman of the Commission appointed by Robert McNamara, President of the World Bank, and hence the report was referred to as the Pearson Report. The report was part of the international effort to put a stop to the steadily declining development efforts. The United States, by far the largest donor, had begun substantially to reduce the amount of assistance being transferred to the developing countries.[17] The Commission was made up of eight members. Six of these members came from developed countries (all of whom had previously served their respective countries as ministers or senior officials) and thus their thirty-five odd recommendations

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[15] Pierre Elliot Trudeau, "International Development as a Requisite for Peace," External Affairs, XX (June, 1968), p. 246; also see Dobell, op. cit.

[16] Partners in Development: Report of the Commission on International Development, L. B. Pearson, Chairman (New York: Praeger Publishers, 1969). Hereafter called Pearson Report.

[17] See Figure 1, Chapter IV and Figure 5, p. 71.

did not deviate substantially from existing donor policies.[18] The main thrust of the Pearson Report was to suggest ways in which the cost of providing aid could be reduced. It covered such topics as the volume and terms of aid, the volume of debt, the effectiveness of technical assistance programmes, and the problem of aid-tying. The document failed to generate a new commitment by donors to increase the flow of financial resources to developing nations.

The third event which affected aid policy in Canada in the late 'sixties was the United Nations Conference on Trade and Development (UNCTAD) held in New Delhi in 1968. The first UNCTAD meeting at Geneva in 1964 had not been prepared to deal with the solidarity and organization displayed by the developing nations. The poorer nations, "the Group of Seventy-seven" as they became known, for the first time collectively pressed their grievances against "the Rich Man's Club" (GATT, DAC, etc.). Not only were the developed countries not making a sufficient or consistent effort in the field of development assistance, but in fact the mechanisms of exchange, "the terms of trade" to quote Raul Prebisch's now famous document,[19] were deteriorating and the gap between rich and poor was widening. The

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[18] White, p. 195.

[19] Raul Prebisch, "Towards a New Trade Policy," Report by the Secretary General of UNCTAD, United Nations, 1964.

Western nations agreed only that a permanent agency, UNCTAD, be established to investigate the problem. The New Delhi conference was to be the showdown between the two groups. The 1968 conference was in no small way responsible for the commissioning of the Pearson Report. The New Delhi meeting failed because of the break in the solidarity of the developing nations and the inability of the western powers to reach a consensus due to the entrenched American position. A great deal of international activity was generated for a brief interval by UNCTAD but subsided until the emergence of OPEC in the early 'seventies. The anticipation of a major confrontation in 1968 at New Delhi did force the western nations to reflect upon their own policies and to attempt some reordering before the conference.

In Canada these three events served to focus the attention of the government on the organizational structure of the EAO. Canada's foreign aid was in the midst of a period of rapid expansion, which, if Canada was to meet the proposed U.N. target of 0.7 per cent Gross National Product for official development assistance, would have to increase even more rapidly. The Trudeau government, using the framework established by H. O. Moran, created a new agency to administer all aspects of Canada's international development assistance. The new agency was called the Canadian International Development Agency (CIDA) and

Maurice F. Strong, an experienced businessman, was named as its president. Whereas the EAO had had only partial autonomy from the administration of the Department of External Affairs, CIDA was to have complete autonomy while still maintaining its accountability to the Secretary of State for External Affairs. Canada's aid budget had a threefold absolute increase from $81.9 million in 1960/61 to $253.2 million in 1968/69 and the programme was now actively involved in more than sixty developing nations.[20] The 1968/69 budgetary allocations still represented only 0.33 per cent of the GNP for 1968[21]--less than half of the U.N. target figure.

Structurally, CIDA differed only marginally from its predecessor. (See Charts 1 and 2). The significant difference between the two agencies was the role of the new Canadian International Development Board. In the previous administration the Director-General had been accountable to the External Aid Board which acted as a consultative mechanism. Under the CIDA reorganization the Board's function was reduced to that of an advisor to the President. The difference between the two is that the former had a voice in policy decisions while the latter does not. In effect CIDA has become a quasi-crown corporation accountable only to the Secretary of State for

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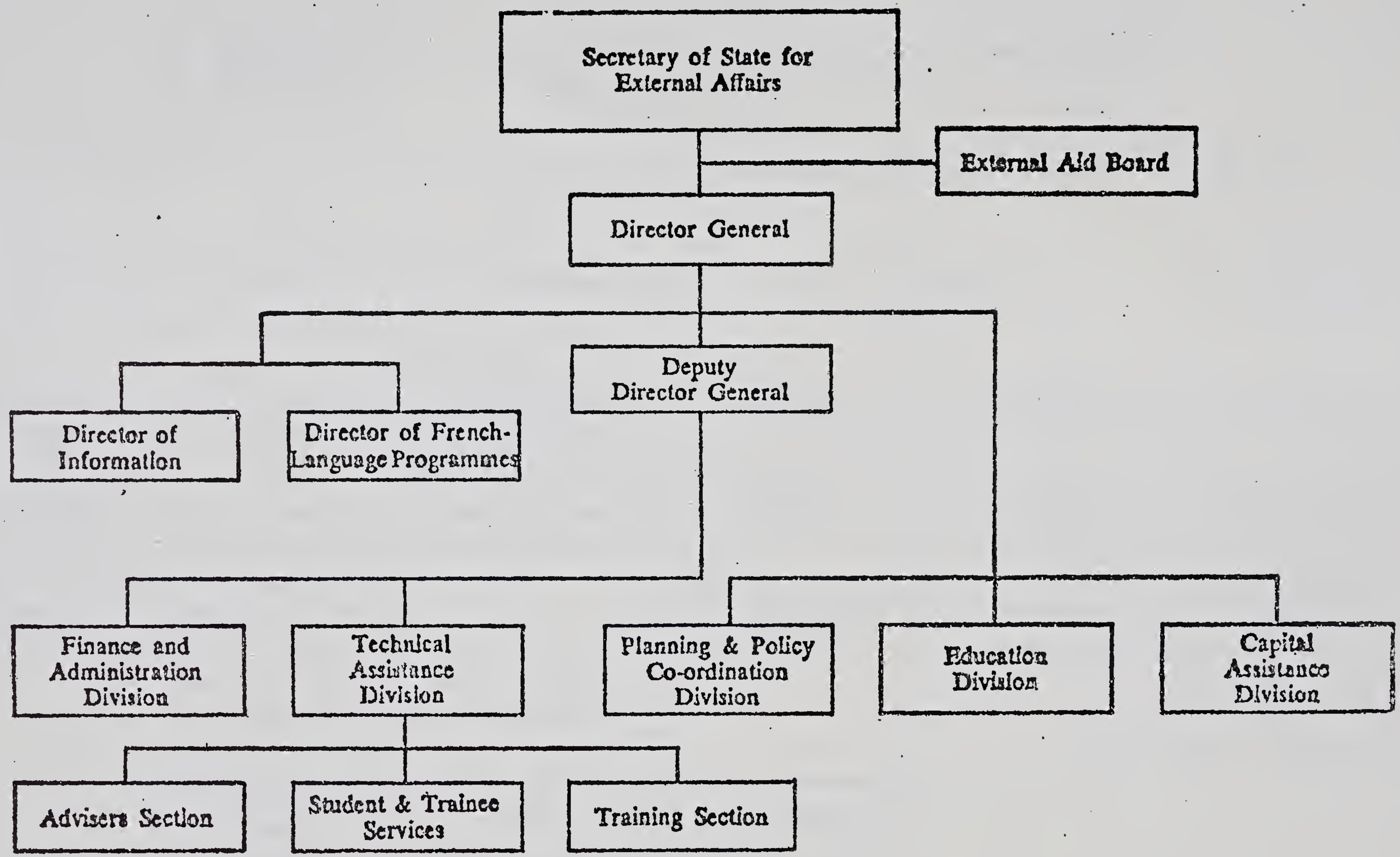
[20] CIDA, Annual Review, '69, p. 26.

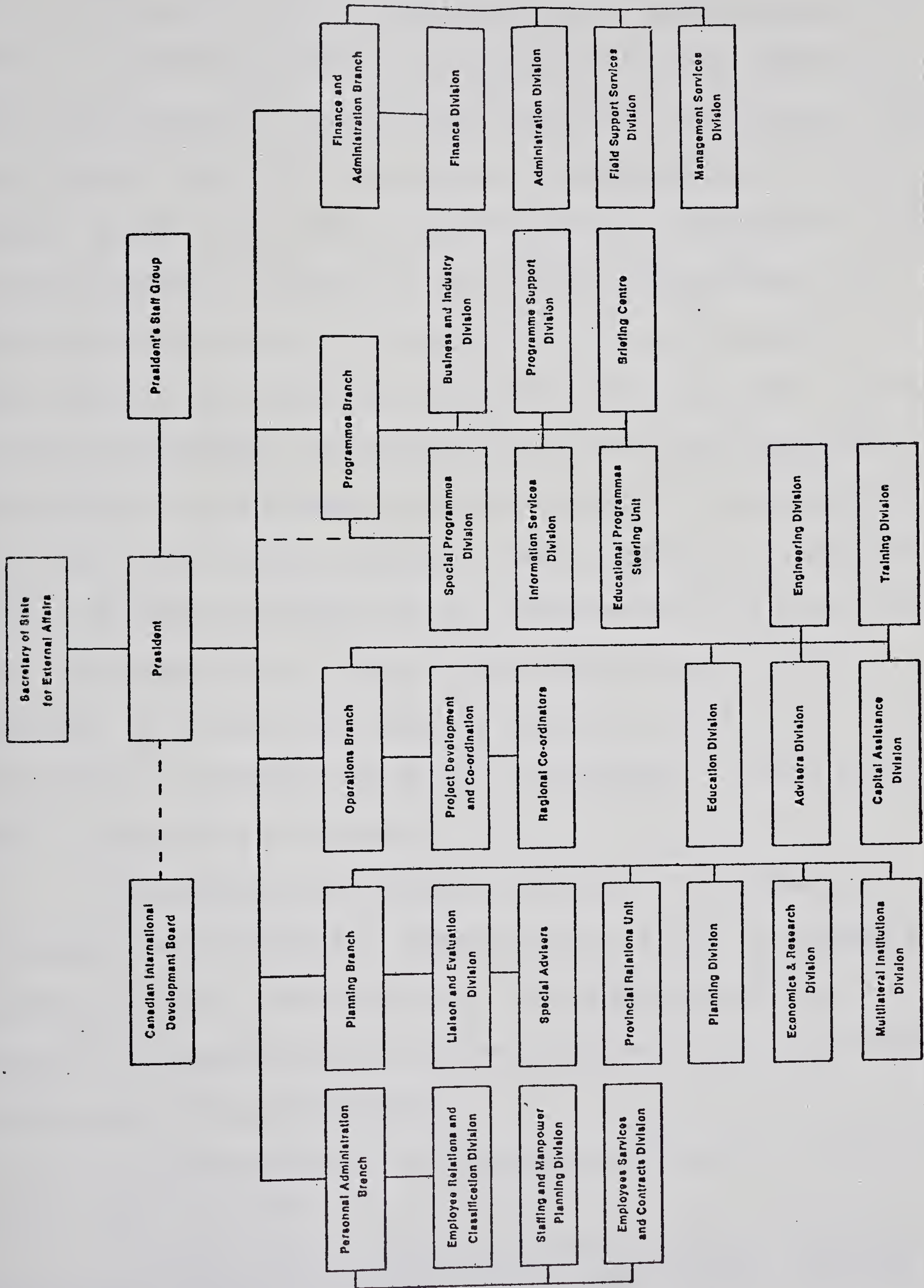
[21] Ibid.

Chart 1. External Aid Office



SOURCE: Keith Spicer, A Samaritan State?, p. 111.

Chart 2. Structure of the Canadian International Development Agency



SOURCE: CIDA, Annual Review, 1969, p. 54.

External Affairs. The reality of its unique position surfaced during the recent debate about the administration of CIDA. The President is not responsible to parliament or, more specifically, the Standing Committee on External Affairs and Defence for CIDA's spending. That Committee has been unable to have the CIDA-commissioned Price Waterhouse Report on the internal problems of the agency tabled before it. The President has only to account in the most general way for Canadian aid spending during the previous year. Specifics of CIDA's spending are privied information not available to the public or parliament without consent of the Secretary of State for External Affairs. The necessity to recognize CIDA's distinct position in our government's foreign policy has also produced an agency which does not come under scrutiny by either parliament or public. This is a regrettable situation which the government, to this point, has not seen fit to correct.

The Trudeau government fulfilled its campaign promises and undertook a comprehensive review of Canada's foreign policy. The resulting 1970 <u>White Paper</u>[22] on Canada's international development assistance policy included the following provisions:

a) the reduction of Canadian procurement regulations

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[22] Canada, Department of External Affairs, <u>Foreign Policy for Canadians: International Development</u> (Ottawa: Information Canada, 1970).

(aid-tying) from the previous 66 per cent level by allowing 20 per cent to be completely untied;

b) shipping costs were no longer to be considered as local costs and could therefore be covered by CIDA;

c) multilateral aid was to be increased to 25 per cent of official Canadian aid;

d) bilateral assistance would increase for francophone programmes;

e) "countries of concentration" would account for in the order of 80 per cent of Canada's aid allocations;

f) the creation of an International Development Research Centre in Canada to provide necessary research for developing countries.

CIDA enjoys the status of having a non-lapsing budget. This concept was introduced by the EAO in recognition of the fact that development projects cannot be constrained by Canada's fiscal budgeting. Projects often require considerable time before plans can become operative. Whereas other government departments have their unspent appropriations transferred to the consolidated revenue fund at the end of the fiscal year, CIDA is allowed to accumulate its unexpended funds. Although this is a worthwhile measure, it has also been a cause of embarrassment for CIDA. The agency has consistently been unable to expend its appropriations with the result that the non-lapsing fund has grown constantly. In 1973/74, CIDA was able to reduce the size

of the fund by donating $100 million[23] to multilateral emergency relief during the energy crisis. In 1974/75 the size of the fund provoked a heated parliamentary debate as rumours circulated in Ottawa that CIDA was looking to empty over $200 million dollars from the fund before its new estimates came before the Standing Committee on External Affairs and Defence.[24] The problem was resolved quite simply when Allan MacEachen, the Secretary of State for External Affairs, added $200 million from the fund to the 1975/76 appropriation. The published figure for Canadian aid in the current fiscal year (1974/75) is $933 million. The amount submitted to the Standing Committee was $712 million to which $221 million was added from the fund.[25]

With the publication of the White Paper, Prime Minister Trudeau announced the appointment of a new President for CIDA. Paul Gerin-Lajoie, a former Quebec political figure, assumed the leadership of the agency. The basic structure of CIDA remained unchanged (see Charts 1 and 2). Maurice Strong moved on to the Canadian embassy in Japan and later took over the United Nations Environment Agency.

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[23]Canadian Institute of International Affairs, International Canada, V (April, 1974), p. 70.

[24]Canada, House of Commons Debates, Vol. 119, No. 80 (Ottawa: Queen's Printer), pp. 3397-3427.

[25]"Statement by the Honourable Allan J. MacEachen, Secretary of State for External Affairs and Minister responsible for the Canadian International Development Agency, to the Standing Committee of the House of Commons on External Affairs and National Defence, April 10, 1975" (Ottawa: CIDA), p. 3.

On April 10, 1975, Allan MacEachen told the Standing Committee that CIDA was in the process of developing a five year plan for Canadian aid policy.[26] The new CIDA strategy for the years 1975-80 was published and released in September of 1975. The Strategy for International Development Co-operation, 1975-80[27] amounts to a new "White Paper" on Canadian aid. Borrowing heavily from the 1975 DAC review,[28] the paper begins by outlining the new position of oil in the international economy and the effect on Third World development of the new oil prices. The Introduction points out quite rightly that it is the non-oil producing LDC's which suffer the most from the increased cost.[29] The Report goes on to point out the disastrous consequences for such least developed countries (LLDC's) as Bangladesh, of both natural and "the recent man-made upheavals." What is not mentioned is the support for OPEC's policies in the Third World![30] Why should countries which face economic ruin at the hands of a greedy cartel wholly support such policies? What are the real implications of this development for the Canadian aid programme? These questions were not addressed in the document.

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[26] Ibid., p. 1.

[27] Canada, Strategy for International Development Cooperation, 1975-1980 (Ottawa: Information Canada, September, 1975). Hereafter called Strategy.

[28] (Paris: OECD; 1975).

[29] Strategy, p. 3.

[30] See "In OPEC We Trust," New Internationalist, No. 35 (October, 1975), p. 18.

Third World countries are calling for a "New International Economic Order" (NIEO).[31] Primary producers in the Third World have been holding regular meetings in an attempt to form other "OPEC's." The Canadian report states:

> Increasingly, it may be expected that the developing countries will attempt to exercise whatever leverage they possess to protect their welfare and to reduce their vulnerability and dependence on the actions of the industrialized nations. The forms of such leverage open to them are various and each brings with it major implications for international peace or security. Cartels of primary commodity producers for such diverse resources as bauxite, copper, iron ore and coffee are already being created. It may not be unrealistic to imagine unilateral debt repudiation, nationalization of foreign investments, and blocking of international monetary reform as further steps developing countries might take. Should frustration turn to complete despair, one cannot rule out the possibility of more violent measures.[32]

Fortunately or unfortunately, from an economic perspective, more "OPEC type" cartels in other commodities are not probable.[33] Unilateral debt repudiation may be forced upon many LDC's as the "zero hour" approaches and the debt load of development overtakes national revenues.[34] Nationaliza-

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[31]Resolution passed by U.N. 6th Special Assembly in April, 1975. See New Internationalist, n. 30.

[32]Strategy, p. 4; emphasis added.

[33]Raymond F. Mikesell, "More Third World Cartels Ahead?" Challenge, XVII (Nov.-Dec., 1974), pp. 24-31.

[34]G. K. Helleiner, "The Development Business: Next Steps," International Journal, XXV (Winter, 1969-70), p. 171.

tion of private industry is a national prerogative under international law, provided adequate compensation is made. International monetary reform is threatening to by-pass the Third World. It is becoming clear that the developing nations have become politically militant regarding development issues. Canada seems to be offering vague rhetoric when concrete policy is required.

It is not the threat, real or imaginary, from the Third World which should motivate Canada's foreign aid in the future. The reason why developed nations should assist developing countries arises solely from the demonstrated poverty of the latter. Before externalizing the development problem, the Canadian government should seriously examine its own development assistance policies. The following Chapter is an attempt to point out some of the problems arising out of Canada's recent development assistance efforts.

CHAPTER 4

THE DIMENSIONS AND DETERMINANTS OF CANADIAN FOREIGN AID

In 1968 the developed countries spent some $15 billion on cigarettes and some $35 billion on alcohol.[1] North Americans spend more every year on their pets than they do on development assistance for the entire Third World. The priority placed upon development assistance, by comparison, seems misplaced.

This study focuses on the development efforts of only one of the developed nations--Canada. It is my opinion that the Canadian aid programme is one of the best *vis à vis* other donors. The criticisms made here can, in all probability, be applied to the other donors. Criticism of our efforts is necessary if Canadians are to play their full role in the development process. Awareness of our own faults will allow us to work toward a rational development policy which will be consistent with

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[1] *Partners in Development: Report of the Commission on International Development*, L. B. Pearson, Chairman (New York: Praeger Publishers, 1969), p. 4.

our aspirations and those of the developing nations.

Canada's aid programme represents a very small portion of the total development assistance made available to the LDC's in that it accounts for only between five and six per cent of the total official development assistance (ODA) flows by DAC members.[2] In absolute terms then, Canada is only a very small donor vis à vis other DAC members.

Appendix 1 of this study shows the relative efforts of the seventeen DAC members. It should be noted however that Official Development Assistance is not fully aid as defined by this study. ODA includes curious items such as "grant-like contributions" and "government long-term capital." The former includes such programmes as P.L. 480 while the latter entails any loans with a maturity of more than one year. Official flows, as defined by DAC, must meet two criteria:

(a) [Programmes must be] administered with the promotion of the economic development and welfare of developing countries as their main objective; and

(b) their financial terms [must be] intended to

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[2]Canada, Strategy for International Cooperation, 1975-1980 (Ottawa: Information Canada, 1975), p. 15; Hereafter called Stretegy.

be concessional in character.[3]

Concessionality has remained undefined and the existence of a vague "intention" apparently has been accepted as sufficient.[4] Those programmes which do not meet the above criteria are not considered as "official flows" but rather as "other official flows." This new category includes such programmes as export credits. ODA, then, is made up of both official and other official flows. Further, ODA figures are normally given as net of amortization on previous lending. This means that capital repayments are subtracted from new lending.[5] DAC figures therefore deduct repayments of the principal but do not deduct interest payments.

When the above is considered in the light of the definition of aid presented by this study, the actual aid included in Appendix 1 is considerably smaller than the figures imply. Myrdal claims that in the case of the United States, the largest aid donor, "making an honest account of what can be classified as genuine aid would . . . reduce the official figures by more than half,

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[3]Development Assistance 1969 (Paris: OECD, 1970), pp. 241-2.

[4]John White, The Politics of Foreign Aid (London: The Bodley Head, 1974), p. 146.

[5]Raymond F. Mikesell, The Economics of Foreign Aid (Chicago: Aldine Publishing Co., 1968), p. 196.

perhaps by two thirds, perhaps even more."[6] Furthermore, this "juggling of statistics" does not take into account the increased substitution of loans for grants (see Figure 4), the fact that capital assistance has been tied in order to favour private industry in the donor countries, or that the prices of goods from the developed countries have risen considerably relative to the commodities of the developing countries.[7] To compound all of this, the ratios of ODA to GNP of the developed countries as a whole have substantially decreased since the late 'sixties (Figure 5). This points to a growing lack of commitment on the part of the rich to the development process.

The Dimensions of Canadian Aid

The amount of foreign aid as defined by this study is dependent on two factors. First, the real resources transferred are contingent upon the form of the transfer. In other words, the grant equivalent value of our transfers is substantially smaller than the nominal figures which equate grants and loans. The second factor is that most Canadian aid is tied, *i.e.* that projects funded must meet Canadian content provisions. As will be seen later, the tying of aid is not nearly as serious in the

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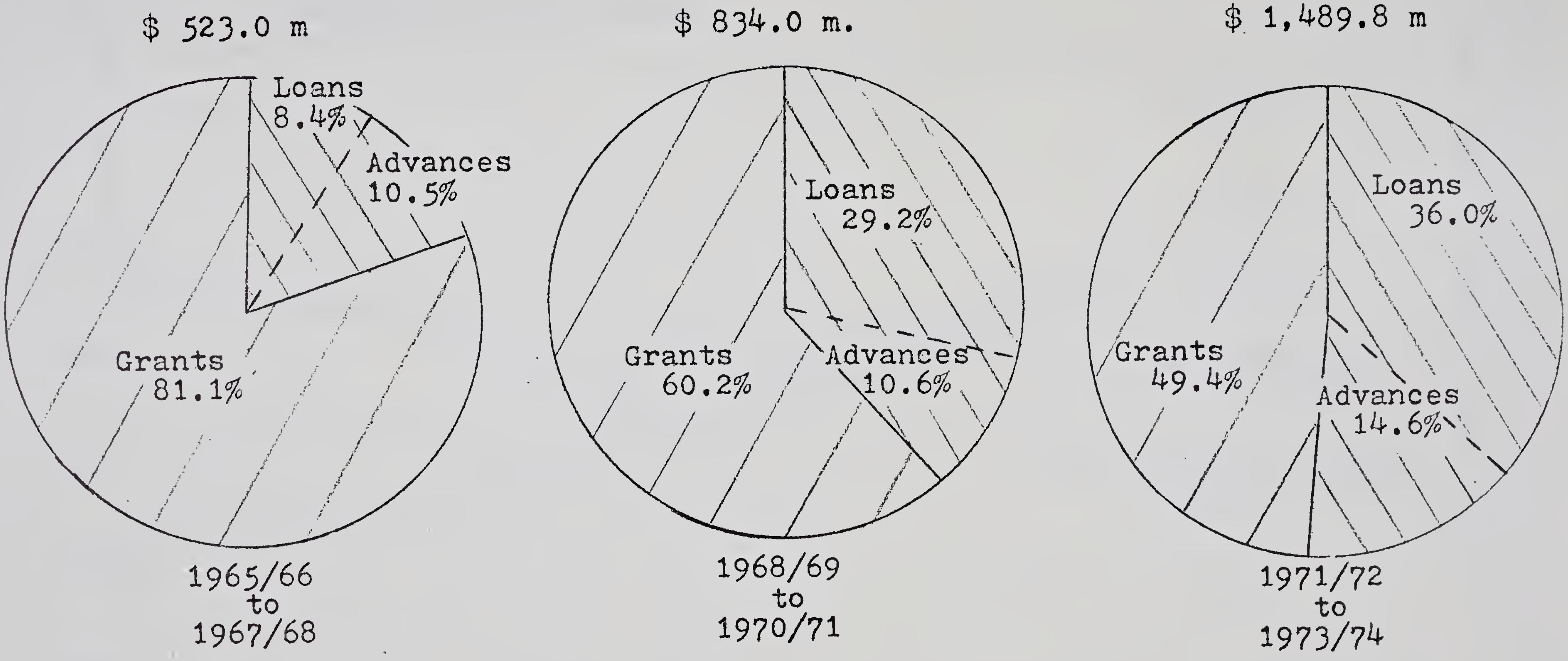
[6] Gunnar Myrdal, *Against the Stream: Critical Essays on Economics* (New York: Vintage Books, 1975), p. 127.

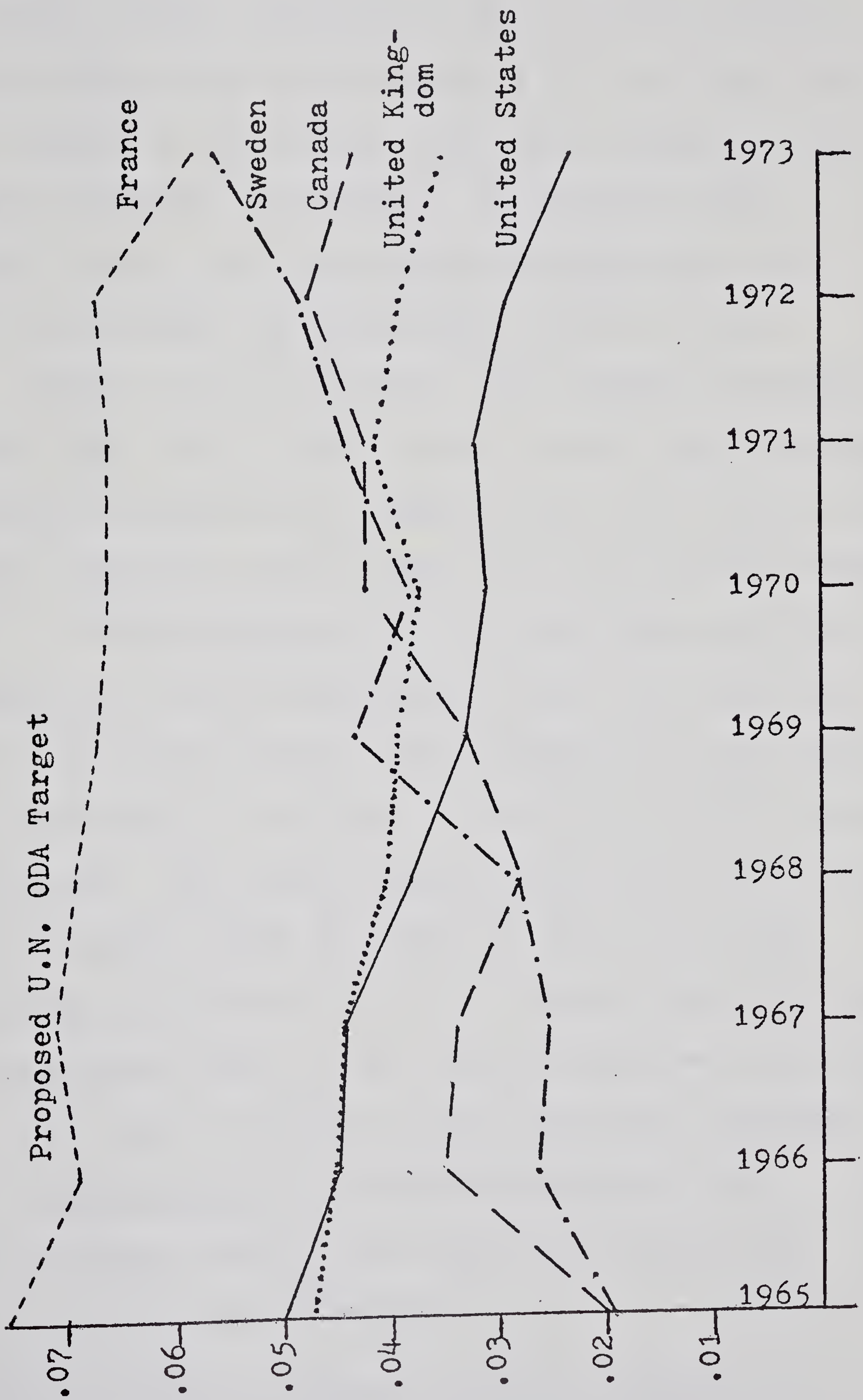
[7] *Ibid.*

Figure 4. The Decreasing Role of Grants in Canadian Development Assistance



SOURCE: CIDA Policy Branch

Figure 5. ODA Efforts, 1965-1973: Canada, United States, France, United Kingdom and Sweden



SOURCE: From Appendix I.

measurement of aid as the manipulation of the terms of the assistance.

In the earlier Chapters it was pointed out that the rate at which loans are discounted is the single most important factor in determining the "aid" content of our development assistance programme. The discount rate used by this study, the long-term government bond rate, is thought to reflect the opportunity cost of public capital. Reuber's study[8] employed four separate discount rates: 5%, 10%, 15% and 20%. Table 3 shows the breakdown of the Canadian programme on a grant-equivalent basis with the nominal amount of the loan but only two discount rates were used. The 10% discount rate is that employed by DAC in assessing the terms of assistance while the long-term government bond rate reflects the assumption of the study. The period covered by the Table is from the 1967/68 fiscal year to 1973/74. The Reuber study covered the period from 1950/51 to 1966/67 (shown in Table 4), and it included Export Development Credits while the figures for this study do not. The exact terms of the loans covered were unavailable from CIDA but an average of the terms was available from DAC's <u>Annual Review</u>. All publications of the Canadian government employ the larger DAC rate in the calculation of the grant elements.

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[8]Grant Reuber, "Canada's Economic Policies Towards Less Developed Nations," <u>Canadian Journal of Economics</u> (November, 1968), pp. 669-698.

TABLE 3

GRANT EQUIVALENT VALUE OF CANADIAN FOREIGN AID DISBURSEMENTS, 1967-1973

($1,000 Canadian)

Year	Grants	Loans	Total	Grant Equivalents		Totals	
				OECD Rate	Bond Rate	OECD Rate	Bond Rate
1967/68	$ 41,260	$ 39,060	$ 80,320	$ 33,849 (86.7%)	$ 28,260 (72.4%)	$ 75,109	$ 69,520
1968/69	35,830	57,980	93,810	52,745 (90.7%)	47,980 (82.8%)	88,575	83,810
1969/70	47,910	90,990	138,900	79,879 (87.8%)	73,938 (81.3%)	127,789	121,848
1970/71	50,960	120,250	171,210	106,655 (88.7%)	99,058 (82.4%)	157,615	150,018
1971/72	53,790	140,130	193,920	111,469 (79.5%)	95,444 (68.1%)	165,259	149,234
1972/73	81,180	150,040	231,220	136,085 (90.7%)	125,686 (83.8%)	217,265	206,866
1973/74	117,130	178,930	296,060	160,722 (89.8%)	149,831 (83.7%)	277,852	266,961

SOURCES: DAC Annual Review, 1974; Canada Yearbook, 1973; CIDA Policy Branch.

TABLE 4

CANADIAN FOREIGN AID 1950-1967

($ millions)

Fiscal years	Grants*	Loans nominal basis*	Loans nominal basis†	Loans (grant-equivalent basis)† 5%	10%	15%	20%	Total aid (grant-equivalent basis)‡ 5%	10%	15%	20%	Total aid as percentage of GNP 5%	10%	15%	20%	Total aid per capita $ 5%	10%	15%	20%
1950/1	12.4							12.4	12.4	12.4	12.4	.069	.069	.069	.069	.91	.91	.91	.91
1951/2	26.8							26.8	26.8	26.8	26.8	.127	.127	.127	.127	1.94	1.94	1.94	1.94
1952/3	28.4							28.4	28.4	28.4	28.4	.118	.118	.118	.118	1.99	1.99	1.99	1.99
1953/4	32.8							32.8	32.8	32.8	32.8	.131	.131	.131	.131	2.23	2.23	2.23	2.23
1954/5	29.0							29.0	29.0	29.0	29.0	.117	.117	.117	.117	1.92	1.92	1.92	1.92
1955/6	38.7							38.7	38.7	38.7	38.7	.143	.143	.143	.143	2.49	2.49	2.49	2.49
1956/7	49.0							49.0	49.0	49.0	49.0	.160	.160	.160	.160	3.07	3.07	3.07	3.07
1957/8	49.4	16.2	24.2	6.1	10.0	12.9	15.0	55.5	59.4	62.3	64.4	.174	.186	.195	.202	3.39	3.63	3.81	3.94
1958/9	55.3	18.3	10.8	2.3	4.2	5.6	6.6	57.6	59.5	60.9	61.9	.175	.181	.185	.188	3.41	3.52	3.60	3.66
1959/0	75.5	.5	—					75.5	75.5	75.5	75.5	.216	.216	.216	.216	4.36	4.36	4.36	4.36
1960/1	82.0							82.0	82.0	82.0	82.0	.226	.226	.226	.226	4.63	4.63	4.63	4.63
1961/2	69.3	43.7	43.7	−2.5	8.2	15.7	21.1	66.8	77.5	85.0	90.4	.178	.207	.227	.211	3.60	4.28	4.70	5.00
1962/3	69.4	61.6	61.7	−3.3	11.0	21.3	28.9	66.1	80.4	90.7	98.3	.163	.198	.224	.242	3.59	4.36	4.92	5.33
1963/4	64.6	41.0	43.8	−3.2	10.0	18.3	23.7	61.4	74.6	82.9	88.3	.141	.172	.191	.203	3.27	3.97	4.42	4.71
1964/5	99.5	126.1	76.0	−6.1	18.8	33.9	43.6	93.4	118.3	133.4	143.1	.197	.250	.281	.302	4.89	6.20	6.99	7.40
1965/6	113.6	99.4	101.5	14.9	37.3	49.5	57.0	128.5	150.9	163.1	170.6	.247	.290	.313	.327	6.63	7.70	8.39	8.78
1966/7	196.9	111.8	109.5	28.3	58.1	73.7	83.0	225.2	255.0	270.6	279.9	.390	.441	.468	.484	11.38	12.89	13.68	14.15
1967/8	164.3	153.6	150.7	63.9	97.5	113.6	122.8	228.2	261.8	277.9	287.1	.373	.427	.454	.469	11.27	12.93	13.72	14.18

*Grant allocations as shown in External Aid Office, *Annual Review* 1966–67, 3 for 1950–51 to 1965–66. Revised figures for 1966–67 and 1967–68 provided by the External Aid Office. Multilateral advances have been included as grants rather than loans. These comprise mainly subscriptions to the International Development Association as well as other agencies such as the Asian Development Bank. No interest is paid on these advances and no repayment is made. In effect, these advances represent equity in these international agencies which in principle can only be repaid in the unlikely event that Canada decided to withdraw from these agencies. It seems more realistic to view these advances as grants than as loans. The figures for both grants and loans represent Parliamentary appropriations.

†Included Special Development Loans, Colombo Plan Wheat Loans and Export Credit Loans on the basis of agreements signed. The grant-equivalent for each loan was calculated as the difference between the principal amount of the loan and the present value of the cash flow of principal and interest payments over the life of the loan, discounted at 5, 10, 15, and 20 per cent respectively. Allowance was made for grace periods as well as for the cancellation and deferment of payments where this has occurred. Details regarding these Loans were provided by the External Aid Office. The estimates represent commitments.

‡Loans, on the basis of agreements signed, plus grant appropriations.

SOURCE: Reuber, p. 676.

The extremely questionable part of the Canadian programme is the use of development loans. According to the recent "White Paper," the total grant element of Canadian assistance "will remain not less than 90 per cent."[9] The development loan policy is economically irrational. If Canada is giving away over 90 per cent of the loan, why is it loaning the funds in the first place? Surely administrative resources freed by changing from loans to grants would almost offset the additional subsidy. The initiation of the Canadian loan programme is an example of Canada continuing to accept other donors' policies when there is no reason for doing so. We have known for some time that the point at which total development inflows will be overtaken by LDC outflows of amortization is rapidly approaching. UNCTAD has forecast 1975 as the year in which this "zero hour" will occur for many LDC's.[10] When this point is reached the development process will become a drain on the economies of the poorer nations forcing many to default on payment. Surely partaking in such a process is contrary to the stated commitment of the Canadian government. Yet having accepted this approach the "New Strategy" seeks to correct a serious malady by applying only first-aid.

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[9] Strategy, p. 30.

[10] Reuber, pp. 677-78.

> Point 15: Relief of Third World Debt
> The Government recognizes the serious problem of indebtedness for developing countries and will continue to take a forthcoming /sic/ attitude towards the provision of debt relief on a case-by-case basis and when exceptional circumstances warrant it.[11]

The real remedy lies in changing the cause of the indebtedness loans. Canada's terms are very soft but they are loans nonetheless. If we are already giving away over 90 per cent of the value then there is little or nothing to support the inefficiency of asking LDC's to repay us. If we intend to encourage other donors, whose terms are often much harsher, to give serious considerations to the implications of indebtedness, then we should begin by abandoning our own loan programme as Australia has done. Further, because we have already foregone the resources transferred by loans, we lose virtually nothing by forgiving all previous indebtedness incurred under the programme. Such a gesture on the part of Canada would in one single effort increase the amount of resources available to recipients of Canadian aid by the total amount of currently outstanding Canadian loans. Canada's voice at international forums would also be substantially increased by such concrete commitments.

I shall return later to the probable causes of continuing the development loan programme. An examination

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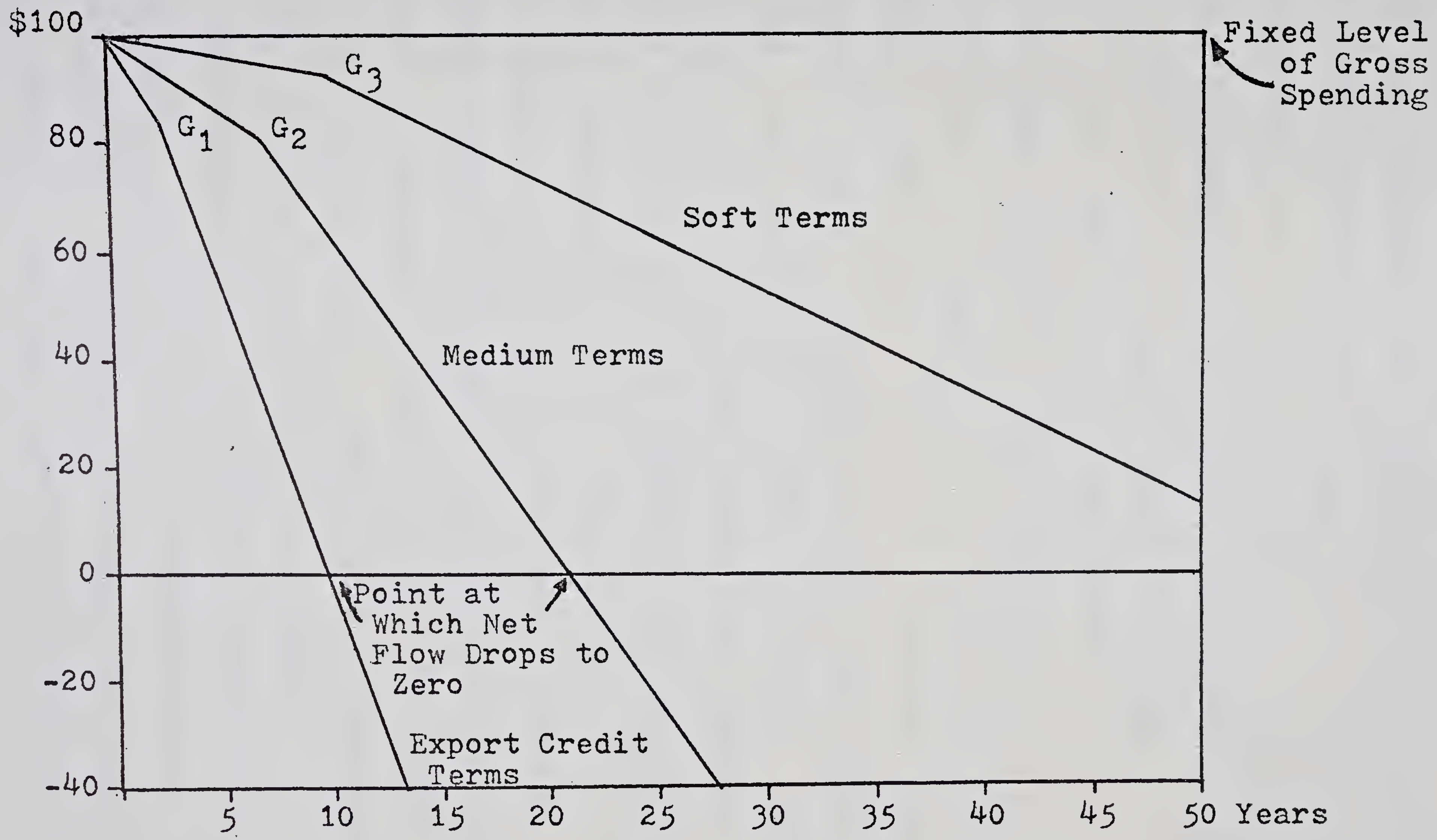
[11] Strategy, p. 33.

of the transfer problem created by debt servicing should serve to clarify the rationale for recommending a change in Canadian policy. If country A receives a Canadian development loan, disregarding for a moment any other loans from other donors, then the following scenario would take place. If A is an ongoing recipient of such loans, i.e. it receives loans from year i to year n, then the only way of preventing the net transfer from falling to zero is constantly to increase the volume of new lending. If the amortization period is held constant at X years (50 years for most Canadian loans) and the amount of the loan in year one is Y or $100, disregarding the complication of a grace period and assuming no interest at all, then in year two A would owe Canada Y/X (100/50) or $2. If Canada wishes to keep the net transfer constant at $100 in year two, the new lending would have to be Y(1+1/X) or $102. In the nth year new lending would have to be $Y(1+1/X)^{n-1}$ so that at the end of 50 years its lending would have to be increased by 169 per cent just to maintain a net transfer of $100 (see Figure 6). The results of the above in terms of policy should be obvious. If new lending fails to increase at the above rate then the net transfer will fall to zero. If we wish to maintain a flow of $100, simply using a grant of $100 per year would, in the long run, be less costly to Canada

Figure 6. Decline in Net Flow of Resources from Canada if Gross Lending Remains Constant



SOURCES: From Mikesell, p. 109 and CIDA Policy Branch

and immeasurably more beneficial to the recipient.

Another problem with Canadian development loans is that they are repayable, for the most part, in Canadian dollars. The Canadian government gives A a certain number of Canadian dollars to be used in Canada. A then spends this money in Canada for its project requirements. After a grace period of say 10 years, Canada then asks A to give back the dollars which have not left Canada. Since A never really had these dollars, it must devote part of its scarce foreign exchange to repaying the loan or it must transfer the Canadian dollar equivalent of its resources to Canada thus forgoing foreign exchange that would have accrued to it had the loan not been made in the first place. This latter point assumes that Canada would have purchased the imports in any event but the contention here is that any exchange is immeasurably better than nothing. The above argument refers to the long-term probable outcome of development lending by Canada. The effects may not surface for another 15 years but since more donors are laying claim to the scarce foreign exchange of developing nations, Canada must now act to prevent its occurrence.

The second factor which affects the quantity of Canadian aid is that it is tied to Canadian sources. As mentioned earlier, the Canadian government has tried since 1968 to reduce the Canadian-content restrictions of CIDA's

expenditures. Aid can be tied by source and/or by project. Either or both of these methods significantly reduces the effect of Canadian aid. The concern of this study is not the recipient benefits per se but rather the analysis of the explicitly stated objectives of the Canadian government. The benefits which accrue to recipients are thereby necessarily included but the policies themselves are the main focal point. Aid has been defined by this study to involve only the transfer of real resources. The terms of the transfer determine whether or not the nominal value of our aid is reduced.

The terms of aid determine whether or not there is a reverse flow which must be deducted from the nominal value of the transfer. The transfer must be accounted for by the Canadian economy, i.e. the Canadian market value of the transfer. The transfer is equal to its market value provided that it is in the form of a grant. If the transfer is made in the form of a loan then it must be discounted to a grant equivalent value. The single exception which arises is the case of a surplus transfer. It may very well be the case that a commodity has no market value in our economy if we have too much of it already. This argument was frequently used in the case of Canadian food aid in the early 'sixties. Surplus transfers of food grains would qualify as aid under the present definition, provided

that the recipient was not adversely affected by it. The question is really one of flows in the Canadian economy which tend to make our aid programme bear the burden of our own inefficiencies.

The real problem in tying arises out of the extreme cost in terms of administrative resources which must be employed to police such policies _vis à vis_ the often minimal benefits which accrue to the recipients. Capital assistance projects must be policed to insure that Canadian firms are not able to gouge aid recipients because of Canadian content regulations. Technical assistance programmes are of extremely questionable value both within Canada and in the developing nations.[12] It would seem that technical assistance can be given without exporting Canadian technicians. The establishment of the International Development Research Centre (IDRC) in 1970 was a large step in what I believe to be the right direction. Much of what we consider Canadian Technology is not applicable in the developing countries. Temperate farming techniques

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[12] See Myrdal, pp. 86-87; C.H.G. Oldham, "Science, Technology, and Development," in Gerald M. Meier (ed.), _Leading Issues in Economic Development: Studies in International Poverty_, 2nd edition (Singapore: Oxford University Press, Inc., 1970), pp. 322-26; A. K. Sen, Choice of Techniques in a Labor Surplus Economy," _ibid_., pp. 348-55; R. S. Eckaus, "Technological Change in Less Developed Areas," in Stephen Spiegelglas and Charles T. Welsh (eds.), _Economic Development: Challenge and Promise_ (Englewood Cliffs: Prentice-Hall, Inc., 1970), pp. 168-78.

are of little value in tropical climates. Our fixation with capital intensity reflects the relative lack of labour and the relative abundance of capital in our factors of production. The opposite situation occurs in most LDC's where the cheapest, i.e. most abundant, factor is labour. What is required is a source of supply for the factor which they lack. Development assistance must transfer capital but not capital intensity. Furthermore, developing nations require technology which is appropriate to their needs, i.e. labour intensive technology.[13]

The development of institutions such as the IDRC is an attempt to address this problem. The administrative cost and the ineffectiveness of transferring our technologists rather than our technology wastes rather than transfers our real resources. The occasional use of technologists in developing countries should be left to non-governmental organizations such as OXFAM, CUSO, etc. rather than squandering the alternatively employable administrative resources of CIDA. The LDC's might also be involved in searching out and hiring the technologists which they require regardless of their nationality. Untying technical assistance means merely accepting the fact that most of the technologists required by developing nations already exist within the developing nations themselves.

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[13]See E. F. Schumacher, "The Case for Intermediate Technology," in Meier, pp. 355-59.

The Determinants* of Canadian Foreign Aid

In 1968 Grant Reuber[14] attempted to statistically investigate the determinants of Canadian foreign aid. His study attempted to explain foreign aid expenditures, from year i to year t, as a function of the donor's gross national product (GNP) and population (P). Hence Reuber's model was of the form:

$$\log A_{it} = a + \beta_1 \log GNP_{it} + \beta_2 P_{it}$$

where A=annual gross aid expenditures. The data matrix was ten countries (Austria, Canada, Denmark, Germany, Italy, Japan, Netherlands, Norway, United Kingdom and United States) by five years (1962 to 1966). The study claims that the model explains 92% of the variation in aid expenditures, i.e. R^2=0.92. There are a number of statistical and logical problems involved in Reuber's model.

The Reuber study excluded four aid donors, France, Australia, Belgium and Portugal, because they were deemed to be "colonial or ex-colonial countries that have actively sought to maintain their influence among their colonies and former colonies."[15] Australia was said to have a "special interest in South East Asia (especially New Guinea)."[16] It should be pointed out, however, that the

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[14] Op. cit.

[15] Ibid., p. 671.

*Statistical determinants

[16] Ibid.

United Kingdom and the Netherlands were also colonial powers which might seek to use aid as a method of influencing former colonies. The United States unquestionably had a special interest in South East Asia of at least the same magnitude as Australia. These four countries were not exceptional cases as Reuber claims, but rather entering these specific donors into the equations reduced the explained variation to 82%, *i.e.* R^2=0.82.[17]

The statistical problems in the Reuber model involve the independent variables. One of the underlying assumptions in ordinary least squares regression is that the independent variables are unrelated to one another. A reasonably strong correlation which exists between the two or more independent variables in a multiple regression equation is referred to as multicollinearity. There is no specific statistical test for multicollinearity but it can be seen by entering the variables in a stepwise regression. The reasoning for this is that if the variables are highly interrelated then both would explain approximately the same amount of variation in the dependent variable, regardless of their order in the stepwise analysis.

In the Reuber model the two independent variables are GNP and population. Some evidence of the high intercorrelation can be found in Appendix I of that study.[18]

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[17] *Ibid.*, p. 672, n. 5.

[18] *Ibid.*, p. 695.

Equation 1.2 states that 91% of the variation in expenditures is explained by GNP (R^2=0.91). Equation 1.3 states that population explains 77% of that same variation. The combined explanation, equation 1.1, is only 92% or 1% higher than the bivariate results for GNP alone. Considering that these figures have been rounded, the increased explanation is virtually nil. One might have expected these results in that labour (population) is a necessary component of the gross national product of an economy. Labour is an important production factor in an economy and the size of the labour force is dependent on the population base. The variables of GNP and population are interrelated by definition and this is shown by the statistical results of the study's model. Since multicollinearity exists in the model, the use and results of regression analysis is unwarranted and perhaps misleading. Reuber's assertion that foreign aid is a "luxury good" cannot be statistically based on the results of the analysis he presents in the study. A per capita gross national product variable might serve to collapse the two variables and thereby avoid the problem of multicollinearity. The study does demonstrate, however, that the size of an aid programme is dependent on the size of the GNP. This only says that richer donors, i.e. higher levels of GNP, are associated with higher expenditures.

A final problem with the Reuber study is the size of the data base. The study uses the UNCTAD data prepared by John Pincus. The rather limited number of observations[19] was necessitated by the lack of existing data at the time the study was attempted. Very little can be determined in the way of trends by the use of such a small number of cases in time-series analysis. Hopefully the improving facilities of DAC will eventually lead to more conclusive results.

The first assumption tested by the present study was that Canada's foreign aid programme was a response to socio-economic conditions in recipient countries.

> There is no doubt . . . that Canadian assistance is going where it is most needed; and I can assure the [standing] committee that the new CIDA strategy for the years 1975-80 will emphasize still further, rather than reverse, this basic orientation.[20]

Canadians have been led to believe that it is Third World conditions which <u>determine</u> Canada's aid programme. A variety of socio-economic variables[21] were compiled for

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[19]Fifty when using 10 donors and 70 when all 14 are used.

[20]"Statement by the Honourable Allan J. MacEachen, Secretary of State for External Affairs and Minister Responsible for the Canadian International Development Agency, to the Standing Committee of the House of Commons on External Affairs and National Defence, April 10, 1975" (Ottawa: CIDA), p. 5.

[21]Discrete variables were also combined to yield new variables, <u>e.g</u>. Per Capita GNP X Population = GNP.

Canadian aid expenditures* from 1965/66 to 1973/74 were disaggregated by grants, loans and food aid. Exports to Canada and imports from Canada were recorded for the same time period. Two forms of data matrices were established. The time series matrix used for examining trends and growth rates was 76 countries by nine fiscal periods. The socio-economic matrix was 59 discrete socio-economic and aid variables by 76 countries. The data was also coded by geographic area as outlined by CIDA. The cases composition of each area was:

1. Asia -- 19 cases
2. Francophone Africa -- 20 cases
3. Commonwealth Africa -- 14 cases
4. Commonwealth Caribbean -- 7 cases
5. Latin America -- 12 cases
6. Other -- 4 cases

One of the recurring problems in development analysis is large variation in size between cases. India's population as compared to Burundi's can cause serious research

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*1. Per capita gross national product
2. Infant mortality rates
3. Literacy rate
4. Daily caloric intake
5. Percentage of primary production in exports
6. Percentage of manufacturing in gross domestic product
7. Population growth rate
8. Real growth rate in GNP for 1960 to 1970
9. Real growth rate in 1971
10. Real growth rate in 1972
11. Real growth rate in 1973
12. ODA receipts (1968-1970) from the United States
13. ODA receipts (1968-1970) from the United Kingdom
14. Population in 1971

problems. Because of India's size, it receives large absolute amounts of development assistance but on a relative or per capita basis its receipts are conversely very small. Two methods were used by this study to standardize cases. In the first instance, Pearson Product Moment correlations, which are susceptible to "outliers" in the data were compared to Tau B correlations which are not because the Kendall correlation ranks rather than measures the deviations in the data. Significance tests were not applicable to the results as the data contained the universe of Canadian aid recipients.

There is no statistical evidence to support the assertions of the Canadian government that its aid programme is determined by the needs of the recipient countries. If the unheard-of correlation acceptance level of ± 0.5 (R^2=0.25) is accepted for both the Pearson Product Moment, and Kendall's Tau B is applied to the Canadian programme, there is still no relationship to indicate a definitive policy. In the simplest terms, the results of the present study indicate that, when taken from the perspective of recipient need, Canada's aid policy is almost wholly random. For example, the assertion that the poverty of a recipient determines whether loans or grants are provided is unsupported. The correlation (r) between a country's per capita gross national product and its

receipt of Canadian development grants range from a low of -0.15 in 1972 to a high of -0.19 in 1970. The correlation between loans and per capita gross national product ranges from -0.09 to -0.16. Another example is that Canada is sending food to the world's hungry. Accepting that Canada has responded quickly and with generosity to world emergencies such as Bangladesh and the Sahel disasters, the bulk of our food aid has purportedly gone to feed the undernourished. One could expect to find relationships, but does not, between food aid and daily caloric intake. In this instance, the correlations range from a low of -0.11 in 1970 to a high of -0.20 in 1972.

Canada also has been criticized for following the policies of Britain and/or the United States. Using the OECD figures on both British and American aid, this accusation is also not substantiated by this study. Canada does not follow Britain and/or the United States in either size or location of its development assistance. Another accusation leveled at the Canadian government is that it favours some geographic or political area such as Asia, Commonwealth or Francophone countries. Only very minor deviations were found when the data was disaggregated by geographic sector. There were no changes sufficient to support such a claim.

In brief, there is no statistical evidence to support

the claim that Canadian development assistance has been determined by needs within developing countries.

John White suggests two factors which go a long way towards explaining aid expenditures--visibility and inertia.[22] By visibility, White means that aid agencies require "some sort of general retrospective test of the success and failure of their operations."[23] In other words, the aid administrator wants to see results. It follows, therefore, that with a fixed amount of aid, the agency will favour smaller recipients _vis à vis_ larger recipients. In essence, White is restating the concentration of aid argument so often voiced by Canadian decision-makers.

The tendency in the past has been to look at aid receipts on a relative or per capita basis. As previously pointed out,[24] this method of standardizing aid receipts does not avoid the vast population differences between large and small recipients. Statistically the absolute or per capita approaches both result in "outliers" which render the results meaningless. In order to test this assertion by White, this study employed a Kendall's rather than a Pearson correlation. Since the Tau B approach ranks rather than measures the deviation, the

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[22] White, pp. 41-45. [23] _Ibid_.

[24] See above, Chapter 4 , p. 88.

cases are automatically standardized. The findings of this approach do not support White's assertion. For the total Canadian programme the Tau B correlation between aid receipts and population was 0.32 as opposed to a Pearson correlation of 0.90. Both correlations are positive, i.e. do not support the hypothesis which stipulates an inverse correlation, and the Tau B correlation is far too low to be meaningful.

A somewhat more reasonable explanation of the relatively high aid receipts in smaller countries would be the administrative structure of the donor agency. If an aid agency is structural according to geographic area (e.g. CIDA) then smaller areas would receive aid on the basis of administrative input. In other words, if so many personnel are assigned to a geographic area then the size of the area becomes crucial to the efficiency of administering all aspects of the programme. A smaller population area means fewer projects and more man-hours per project and therefore a greater ability to handle efficiently a relatively larger budget. As the size of the client population increases the number of projects grows geometrically and man-hours are less efficiently used. As the programme grows there is a necessity to increase the number of agency staff in that area proportionate to the number of projects and funds required.

There is therefore a diseconomy of scale in the administration of larger programmes because more and more man-hours are used to coordinate the programme.

The second factor which, according to White's study, seems to explain aid expenditures is inertia. By inertia White means that the aid programme itself is the best determinant of aid expenditures and distribution. The current jargon refers to this inertia factor as "incrementalism."[25] The example often cited by incremental analysts is that the best predictor of today's weather is yesterday's weather. In this sense, White says, present aid spending is determined by previous aid spending.

> If one compares the volumes of aid to different countries in a given year, and tries to identify some single factor which explains the differences between them, the factor which fits best is the volume of aid to each country in the <u>previous</u> year.[26]

The technical test for incremental spending policy is to calculate the correlation coefficient between aid flows to recipients in different years.

The DAC found the correlation coefficient for the period of 1964 to 1967 varied between 0.97 and 0.98.[27] The present study compared Canadian aid spending in 76

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[25] David Braybrooke and Chalres Lindblom, "Types of Decision Making," in James N. Roseman, ed., <u>International Politics and Foreign Policy</u>, second edition (New York: Free Press, 1969).

[26] White, p. 43; emphasis added.

[27] <u>DAC Annual Review</u>, 1969, p. 178.

countries over the fiscal period of 1965/66 to 1973/74. The approach used tested for incremental spending for total expenditures as well as disaggregating the data by grants, loans and food aid. The incremental spending thesis was strongly confirmed by the results in all categories. For total aid (grants and loans) since 1965 the correlation coefficient of aid spending compared to spending in the previous year is given in Table 5.

TABLE 5

CORRELATION COEFFICIENTS: PRESENT SPENDING WITH SPENDING IN PREVIOUS FISCAL YEAR

Type	1966	1967	1968	1969	1970	1971	1972	1973
Grants	0.99	0.90	0.89	0.89	0.95	0.91	0.91	0.97
Loans	0.97	0.69	0.97	0.98	0.98	0.93	0.94	0.91
Food	0.97	0.99	0.99	0.99	0.98	0.98	0.66	0.89
Total*	0.99	0.97	0.97	0.97	0.99	0.93	0.96	0.88

*Total=Grants + Loans

It is obvious from Table 5 that Canada's aid programme has followed, almost totally, the previous year's spending. The results are taken over 76 recipients and over nine years. Canada's aid programme is therefore extremely static. If country X received Y dollars last year, it will receive Y±i dollars this year (i=an incremental deviation). To use White's terminology, the CIDA programme is a captive of its own inertia.

The most striking point in the Table is the fact that food aid has followed the pattern found for grants and loans. The sharp decline in the correlation coefficients in 1972 reflects the situation which arose in Bangladesh. The coefficient shows some signs of returning to the previous incremental trend in 1973. Subsequent observations should confirm this return to the incremental norm.

What does it mean to say CIDA's spending policy is incremental? Basically, incrementalism means that the agency has become its own focal point. Incrementalism arises when an agency does not formulate specific objectives or when it does not attempt to bring its policies to bear on specified objectives. The underlying premise in incremental theory is that fundamental policy changes cannot originate within the agency but are only possible from without, as in the case of natural disasters (Bangladesh). As time passes, an incremental policy gathers more and more momentum and any fundamental change required also grows incrementally. It is therefore necessary to base an incremental policy on a sound programme because all faults in that programme will grow incrementally as well. The previous example of the development loan programme is a case in point. What was initially envisaged as a method of substantially increasing the total volume of aid has

brought with it the unforeseen problem of unmanageable debt burdens in the Third World and the consequent decline in the volume of aid transferred. Because the development loan programme has been gathering momentum since the early 'sixties, agencies such as CIDA are unable to effect what would be a fundamental policy change. What we find instead is an incremental solution such as rescheduling of loans rather than fundamental change such as discontinuing the programme or forgiving the loans.

CIDA has coupled incremental spending with astronomical growth. The rate of incremental change has been exponential rather than linear. In order to derive the rate of growth in CIDA's spending it was assumed that:

$$E_t = E_{t-1} + g(E_{t-1}) \quad \text{or}$$

$$E_t = (1+g)E_{t-1}$$

where E_t represents present spending and g represents the annual growth rate. The general model derived from the above is:

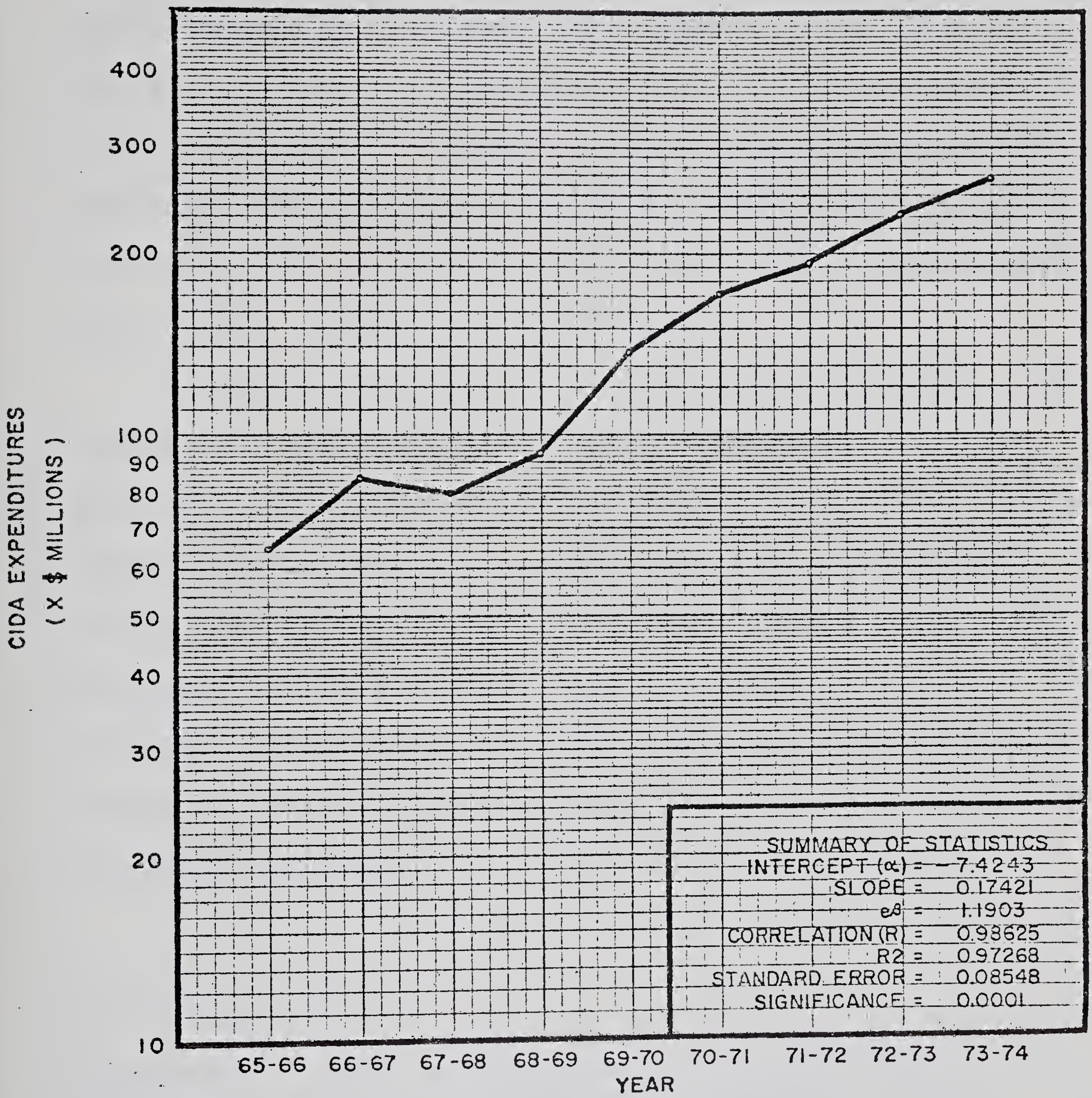
$$E_t = (1+g)^n E_{t-n}$$

where n represents the number of years being examined. This model can be fitted to ordinary least squares such that:

$$\text{Log } E_t = \text{Log}\,\alpha + \beta \text{Log } t$$

where = the log of the intercept value and $\beta = e^{(1+g)}$.

Figure 7



LOGARITHMIC REGRESSION OF CIDA EXPENDITURES
1965-66 TO 1973-74

Hence the growth rate g can be derived by subtracting 1 from the antilog of β, i.e. (antilog β - 1.0).[28] When CIDA spending (grants and loans) was examined from 1965/66 to 1973/74, the rate of growth was found to be 19.03% compounded annually![29] Figure 7 visually demonstrates the results. The correlation (R) was 0.99 and the explained variation (R^2) was 0.97 or 97%. The results were significant at the 0.00001 or 99.999% level.

CIDA, according to the recent "White Paper," will continue to emphasize the growth of expenditures. How much Canada gives under its aid programme is not as important as how we give it. In the long term, incremental policy will lead to a disillusionment on the part of the government, the recipient, and the taxpayer. Canada's aid programme should grow but policy must be based on clearly stated objectives derived from recipient needs rather than previous spending.

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[28] See Boris Pesek, "Economic Growth and Its Measurement" in W. L. Johnson and D. R. Kamerschen, eds., Readings in Economic Development (Cincinnati: South Western Publishing Co., 1972), pp. 132-154.

[29] Growth not adjusted for domestic inflation. When converted to a constant figure this growth rate is 8.7%. The disaggregated growth rates support the previous argument regarding development loans. The growth rate for grants was 8.9% in current terms and -0.5% in real terms while the growth rate for loans was 37.7% in current terms and 25.8% in real terms!

CONCLUSION

This study has considered some of the more relevant theoretical considerations of foreign aid and has applied these and other criteria to Canadian foreign aid policy since 1965. The study can therefore be divided between theoretical considerations of foreign aid and the Canadian case study.

A number of conclusions were formulated by this study regarding foreign aid theory. The definition of foreign aid advanced by this study is as follows.

> Foreign aid is the official unidirectional transfer of real resources from developed nations to developing nations, for the purpose of promoting the economic development of the recipient.

The measurement of foreign aid is contingent upon the operating assumptions posed by this definition. The definition explicitly denies that commercial transactions can be classified as foreign aid because the transfers must be unidirectional. This distinction led to three findings which were felt to be significant regarding the measurement of aid flows.

First, by using the noncommercial approach, foreign aid can be looked at as forming a continuum, which ranges

from grants of convertible currency (100% aid) to fully commercial transactions (non-aid). This approach seems useful in dealing with the multitude of terms which are often attached to an aid transfer.

Second, it was found that the discount rate employed in evaluating the "grant-equivalent" value of aid is the single most important factor in measuring aid. This study concluded that the only rate which should be employed in calculating the grant equivalent is the long-term government bond rate. Since the capital involved is public rather than private, it is felt that rates applicable to the private sector are inappropriate and often misleading.

Finally, the employment of this scalar technique and the present definition is useful in quantifying transfers-in-kind. Again, the most important factor in quantifying commodity aid is the terms of the transfer. Grants-in-kind are aid to their full value provided the commodities can be assigned a market value in the domestic economy and/or in the recipient country. A loan which applies to a commodity should be measured at the world market price because the domestic price reflects a domestic subsidy.

Chapter 3 of this study was broadly aimed at updating the history of Canadian foreign aid. Keith Spicer's book, A Samaritan State?, provides a thorough examination of the history of Canadian foreign aid before 1965. Unfortunately, there has been no follow-up to that

study although it would certainly be useful.

The case study introduced by Chapter 3 and continued in Chapter 4 is felt to be the relevant issue for the present study. There were basically two questions examined:

1) How much "foreign aid" does Canada give?

2) What determines Canada's foreign aid spending?

The answer to the first question is that Canadian "foreign aid" is somewhat less than the figures published by CIDA. The relevant point raised was the difference between the figure derived when the OECD discount rate is employed and the results when the long-term government bond rate is used. The fact that either discount rate results in a very high proportion of concessionality, i.e. grant equivalent, must force serious reconsideration of Canada's development loan programme. The loan programme should be eliminated as it is counter-productive to the development process to which the Canadian government has stated its commitment.

The original problem posed by this study was to evaluate the magnitude of Canada's response to the needs of recipients. The conclusion of this study is that there is no statistical relationship between recipient needs and Canadian policy. This random pattern of distribution of Canadian funds suggested a high degree of ad hoc decision-making. This subsequent hypothesis was almost perfectly confirmed when prior spending was used as a criterion. The

levels of incrementalism visible in Canada's foreign aid policy reflect the preoccupation of CIDA with disbursement to the virtual exclusion of all else. The recent "White Paper" fails to provide what is uregntly required by the agency--concrete development objectives. Indeed, the major focus of the paper is increasing disbursements in order to reach the internationally accepted figures of 0.7 per cent of the GNP. At a current growth rate of over 19 per cent annually, the directionless spending will become more serious. The Canadian government has been under considerable pressure both domestically and internationally to reach the U.N. target figure. What is required is not more aid but better aid. The question of quantity should not be addressed before the quality of the programmes has been examined. The Canadian effort to increase the amount of its assistance to developing nations shows a commitment to development but has also forced CIDA to emphasize disbursement and has not allowed the agency to examine its objectives in concrete terms. In point of fact, Canada could increase its "foreign aid" substantially without increasing its expenditures.

APPENDIX II

NET FLOWS OF OFFICIAL DEVELOPMENT ASSISTANCE FROM DAC MEMBERS TO LESS DEVELOPED COUNTRIES AND MULTI-LATERAL AGENCIES, 1965- 1973

Country	1972 Per capita $ US	RANK		1965	1966	1967	1968	1969	1970	1971	1972	1973
Australia	3420	11	A	119	126	157	160	175	202	202	267	286
			B	.52	.53	.60	.57	.56	.59	.53	.59	.44
			C	4	3	3	3	3	4	4	4	8
Austria	2730	13	A	32	31	26	23	14	11	12	18	37
			B	.34	.31	.24	.20	.11	.07	.07	.09	.13
			C	9	10	12	14	17	17	17	16-17	16
Belgium	3600	9	A	102	76	89	88	116	120	146	193	235
			B	.59	.42	.45	.42	.50	.46	.50	.55	.51
			C	2	7	5	5	4-5	5	5	5	5
Canada	4760	3	A	97	187	198	175	245	346	331	492	515
			B	.20	.35	.34	.28	.33	.42	.42	.47	.43
			C	11	9	9	11	10-11	6	8	7	9
Denmark	4210	5	A	13	21	26	29	54	59	74	96	130
			B	.13	.19	.21	.23	.38	.38	.43	.45	.46
			C	14	13	14	13	8-9	7-8	7	8	6
France	3790	8	A	752	745	826	874	955	971	1075	1320	1486
			B	.75	.69	.71	.69	.67	.66	.66	.67	.58
			C	1	1	2	1	2	2	2	2-3	2
Germany	4170	6	A	431	440	528	553	579	599	734	808	1102
			B	.38	.37	.43	.41	.38	.32	.34	.31	.32
			C	7	8	8	6	8-9	10-11	10	11	10
Italy	2180	15	A	60	78	155	146	130	147	183	102	192
			B	.10	.12	.22	.19	.16	.16	.18	.09	.14
			C	15	15	13	15	15-16	15	16	16-17	17
Japan	2750	12	A	244	283	384	356	436	458	511	611	1011
			B	.28	.28	.32	.25	.26	.23	.23	.21	.25
			C	10	11	10	12	13	13-14	13-14	14-15	13

Appendix I
(Continued)

Country	1972 Per capita $ US	1972 Per capita RANK		1965	1966	1967	1968	1969	1970	1971	1972	1973
Netherlands	3430	10	A	70	94	114	134	143	196	216	307	322
			B	.36	.45	.49	.53	.50	.61	.58	.67	.54
			C	8	5-6	4	4	4-5	3	3	2-3	4
New Zealand	N/A	N/A	A	N/A	N/A	N/A	N/A	12	14	17	19	29
			B	--	--	--	--	.22	.23	.23	.23	.27
			C	--	--	--	--	14	13-14	13-14	13	12
Norway	3900	7	A	11	14	15	27	30	37	42	63	84
			B	.16	.18	.17	.29	.30	.32	.33	.43	.45
			C	13	14	15	9	12	10-11	11	9	7
Portugal	860	16	A	21	24	47	35	70	41	99	154	75
			B	.57	.59	1.02	.69	1.29	.67	1.42	1.79	.71
			C	3	2	1	2	1	1	1	1	1
Sweden	5080	2	A	38	57	60	71	121	117	159	198	275
			B	.19	.26	.25	.28	.43	.38	.44	.48	.56
			C	12	12	11	10	6	7-8	6	6	3
Switzerland	4700	4	A	12	14	12	23	30	30	28	65	64
			B	.08	.10	.07	.13	.16	.15	.12	.21	.15
			C	16	16	16	16	15-16	16	15	14-15	15
United Kingdom	2720	14	A	472	486	485	413	431	447	562	609	603
			B	.47	.46	.44	.40	.39	.37	.41	.39	.35
			C	6	4	6-7	7	7	9	9	10	11
United States	5510	1	A	3465	3459	3567	3303	3092	3050	3324	3349	2968
			B	.50	.45	.44	.38	.33	.31	.32	.29	.23
			C	5	5-6	6-7	8	10-11	12	12	12	14

A = Net Flows ($US Millions) ; B = Flows as % GNP at market prices ; C = Rank of member based on flow as % GNP.

SOURCE : DAC *Annual Reviews*, 1965-1974.

APPENDIX II

THE GRANT ELEMENT IN DEVELOPMENT LENDING*

When loans are made on concessionary terms, these may be said to comprise an aid element, and it is reasonable to wish to estimate this grant element in cash terms and regard it as the sacrifice (or benefit) associated with such loans. The natural definition of the grant element is the difference between the face value of a loan and the present value of all future repayments (amortisation and interest payments), discounted at a proper rate of interest.[1]

The Grant Element

The choice of the proper discount rate cannot, in the absence of an integrated world capital market, be the same if the attention is focussed on the sacrifices of the lenders and on the benefits of the borrowers. In the first case, a rate expressing the prevailing long-term yield on public capital is an appropriate measure of the opportunity cost of public loanable funds. In the second case, the alternative rates available to borrowers in underdeveloped

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*SOURCE: Gorin Ohlin, Foreign Aid Policies Reconsidered (Paris: Development Assistance Committee of the OECD, 1966), pp. 101-105.

[1]Cf. John A. Pincus, "The Cost of Foreign Aid," Review of Economics and Statistics, XLV (1963), pp. 360-367.

countries are more elusive: their access to free capital markets is sporadic. In any case, the long term rate that would represent the borrowers' opportunity cost is clearly a good deal higher than that which pertains to the lenders.

The present note is only concerned with the formal aspects of the problem: given the terms of a development loan and an appropriate rate of discount, how can the concessionary element readily be estimated?[2]

Public loans of the kind we are here concerned with typically provide for a grace period of a certain number of years during which no repayment of principal is made. Thereafter, principal is usually repayable in equal instalments, although other amortisation principles are occasionally followed. In the case of certain United Kingdom loans with maturities of 25 years and grace periods of seven years, interest payments are also waived during this grace period, which obviously reduces the effective rate of interest.

In the following, it is for convenience assumed that amortisation and interest payments are made continuously, rather than at discreet intervals of six months or a year. We use the notation:

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[2] In Wilson E. Schmidt's paper, "The Economics of Charity: Loans versus Grants," Journal of Political Economy, August, 1964, which appeared after the completion of this note, the discrete formulas for present cost are derived, though without consideration of grace periods.

L	face value of the loan
P	present value of future repayments at time of lending
$p = P/L$	present value as share of face value
$S = L-P$	subsidy or grant element
$s = S/L$	grant element as share of face value
i	rate of interest
q	rate of discount
T	maturity
G	grace period
D	net indebtedness

In the first place, it may now be observed that, if the rate of interest is not concessionary, there can be no grant element in the sense in which the term is used here. The grace period and the amortisation schedule, no matter how important they may be in other respects, will not alter the fact that the discounted present value of repayments will equal the face value.

The outstanding debt at time t is $D(t)$, interest payments, therefore, $i\,D(t)\,dt$, and amortisation payments $D(t)\,dt$. The present value of these payments, discounted at a rate q, is:

$$P = \int_0^T (i\,D(t) - D(t))\,e^{-qt}\,dt \qquad (1)$$

As $D(0) = 0$, partial integration gives:

$$P = L - (q-i)\int_0^T D(t)\,e^{-qt}\,dt \qquad (2)$$

With a rate of discount different from the interest rate of the loan, a grant element will arise, and it will depend on the mode of amortisation. I assume that during the grace period, G, there is no repayment of principal but that principal is then repaid in equal instalments in the remaining years of the loan, at a rate of $\frac{1}{T-G}$. During the first G years, only interest payments are made: their present value is:

$$P_1 = \int_0^G i\ L\ e^{-qt}\ dt = \frac{i}{q}\ L(1 - e^{-qG}) \qquad (3)$$

The present value of the repayments of principal and payments of interest made after the grace period is:

$$P_2 = \int_G^T \left[\frac{L}{T-G} + iL\ (1 - \frac{t-G}{T-G})\right] e^{-qt}\ dt \qquad (4)$$

which is easily shown to be:

$$P_2 = \frac{i}{q}\ L\ e^{-qG} + (1 - \frac{i}{q})\ L\frac{e^{-qG} - e^{-qT}}{q(T-G)} \qquad (5)$$

Adding P_1 and P_2 gives the solution for this case. If the present value is written as a proportion of the face value:

$$p = \frac{i}{q} = (1 - \frac{i}{q})\ \frac{e^{-qG} - e^{-qT}}{q(T - G)} \qquad (6)$$

If there is no grace period, i. e. G = 0, this reduces to:

$$p_o = \frac{i}{q} + (1 - \frac{i}{q})\ \frac{1 - e^{-qT}}{qT} \qquad (7)$$

or:

$$s_o = (1 - \frac{i}{q})\ (1 - \frac{1-e^{-qT}}{qT}) \qquad (8)$$

For very short-term loans, qT is fairly small, and as an illustrative approximation one may expand e^{-qT} in series and drop the terms beyond the second power. This reduces (8) so that the grant element is simply:

$$s_o = \tfrac{1}{2}(q-i)\ T \qquad (9)$$

In other words, the concession in regard to the rate of interest is applied to the average balance of the loan over the term of maturity.

Generally, however, this approximation is not permissible, and the formula used to estimate the grant element in long-term loans with a grace period is (6), or more correctly, its complement:

$$s = (1 - \frac{i}{q})\ (1 - \frac{e^{-qG} - e^{-qT}}{q\ (T-G)}) \qquad (10)$$

In Tables 1-4, this expression has been calculated for loans of 10, 20, 30 and 40 years maturity, with grace periods of 0, 5 and 10 years.

The tables actually show great regularity, and when the discount rate is not too high, it is possible to use the following rules of thumb:

Each concession of one percentage point in the interest rate (below the discount rate, seen as an alternative for the lender) gives rise to a grant element of:

4 per cent of the face value for a 10-year loan;

7 per cent for a 20-year loan;

9 per cent for a 30-year loan, and

10 per cent for a 40-year loan.

A grace period will increase the grant element by the proportion G/T. Take as an example a loan given at 30 per cent, rather than a prevailing normal rate of 6 per cent, maturing in 20 years and with a grace period of 5 years. The grant element will be:

$$3 \times 7 \times \left(1 + \frac{5}{20}\right) = 26\%$$

which is in accordance with Table 2, which shows 25.5 per cent.

An even more approximate way is to use the following formula:

$$s = (q - i)\left(2.5 + \frac{T}{5}\right)\left(1 + \frac{G}{T}\right) \qquad (11)$$

The simplicity of this formula is gained at some sacrifice of precision, but it is serviceable in the relevant range[1]. To illustrate, a 10-year loan at 4 per cent, discounted at a rate of 6 per cent, will contain a grant element of

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[1]When the grace period is relatively short compared to the maturity, expansion of (10) shows that it can be written as:

$$s = (q - i)\left(1 + \frac{G}{T}\right)\frac{1}{q}\left(1 - \frac{1 - e^{-qT}}{qT}\right)$$

Now, $\frac{1}{q}\left(1 - \frac{1 - e^{-qT}}{qT}\right) = T\left(\frac{1}{2} - \frac{1}{3!}qT + \frac{1}{4!}q^2T^2 - \ldots\right)$ but when qT 1, this series converges very slowly. However, when q = 6 per cent, a least-squares fit over the range between 10 and 40 years gives the linear approximation $2.45 + 0.205\,T$.

$(6-4)\ (2.5 + 2) = 9$ per cent.

The correct figure is 8.3 per cent, according to Table 1. A 30 year loan with a 5-year grace period, carrying an interest rate of 3 per cent and discounted at 6 per cent has a discounted present value of

$$(6 - 3)\ (2.5 + 6)\ (1 + 1/6) = 30 \text{ per cent.}$$

The correct ratio, according to Table 3, is 30.5 per cent. A soft development loan of 40 years maturity, a 10 year grace period, and a 2 per cent rate of interest, discounted as in the other cases at 6 per cent, gives:

$$(6 - 2)\ (2.5 + 8)\ (1 + \tfrac{1}{4}) = 52 \text{ per cent}$$

while the actual figure in Table 4 is 49.4.

If not only amortisation but interest as well is waived during the grace period, a direct and substantial grant element will, of course, arise, whatever the rate of discount. Its present value will be that of P_1 in (3). Thus, for a loan of the type given by the United Kingdom, a maturity of 25 years, a grace period of 7 years and a rate of interest of 5.5 per cent, this waiver amounts to a grant element of 31.2 per cent, even if 5.5 is taken as a normal market rate so that no concession is involved on that account - which is, more or less, the principle on which the interest on United Kingdom loans has been set.

Such a waiver may, of course, alternatively be seen as a reduction of the effective rate of interest. The

effective rate of interest may be said to be that rate of discount which would make the present value of the remaining flow of repayments equal to the face value. That present value is expressed by P_2 in (4), and the effective rate of interest will be that q which makes $P_2 = L$. For the loan described in the previous paragraph, the waiver of interest payments during the grave period turns out to reduce the effective rate of interest from 5.5 to 2.75 per cent.

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